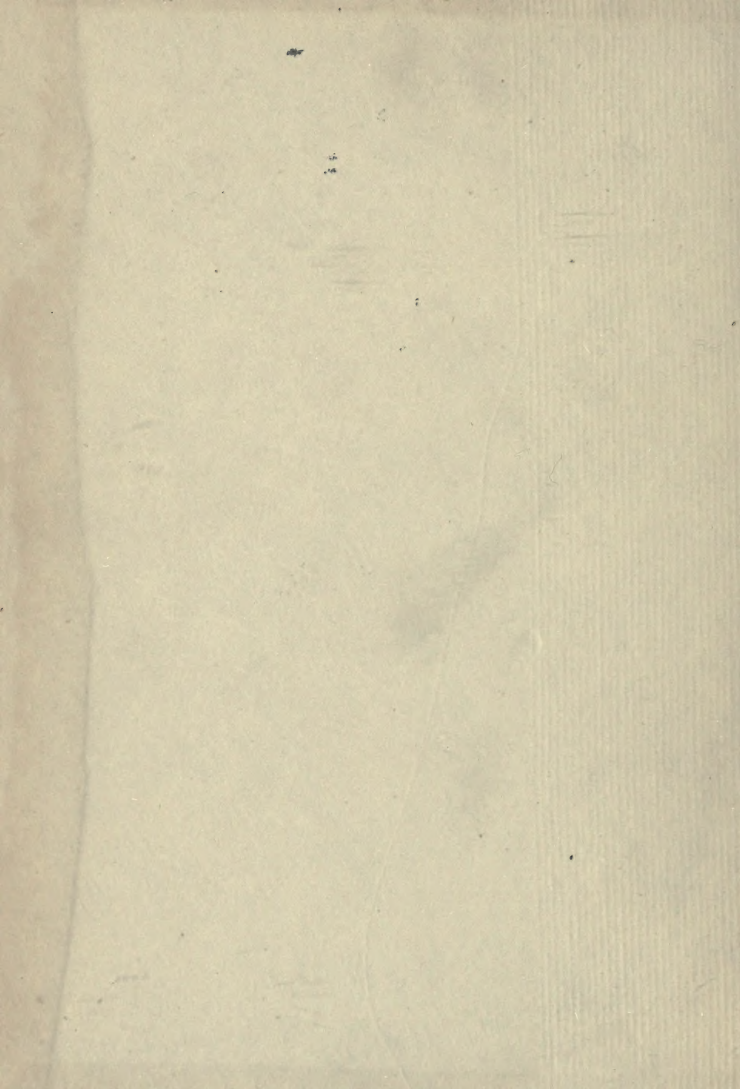



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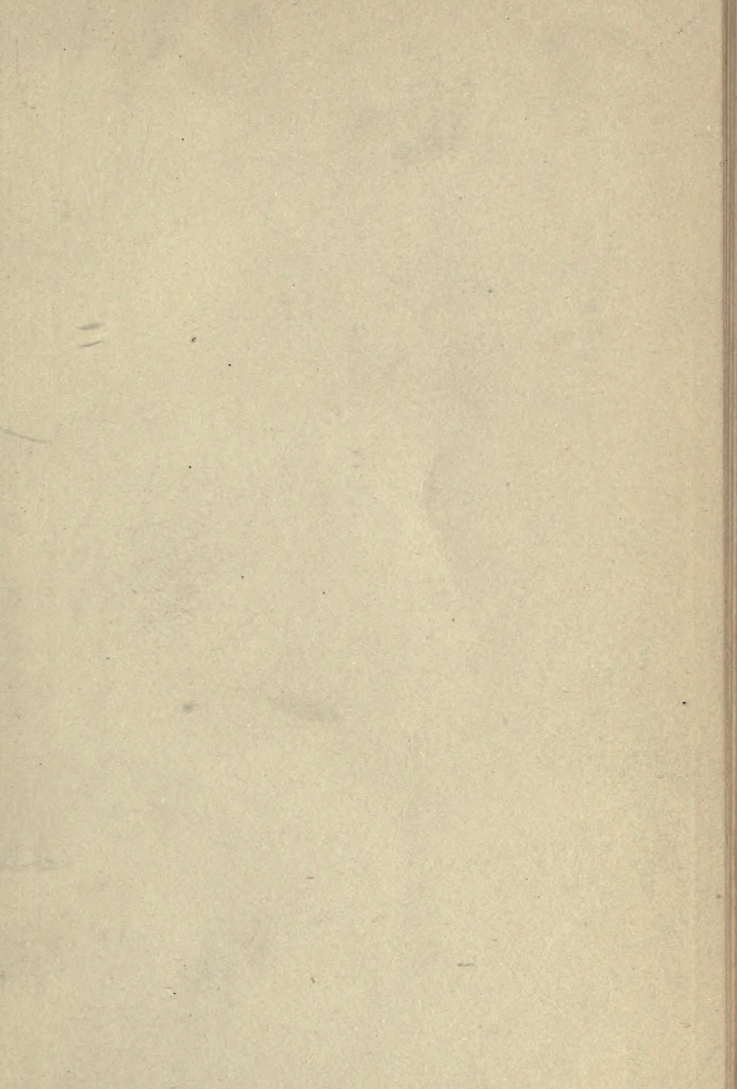


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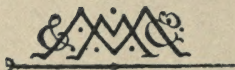




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THE POLITICAL ECONOMY OF WAR



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THE
POLITICAL ECONOMY
OF WAR

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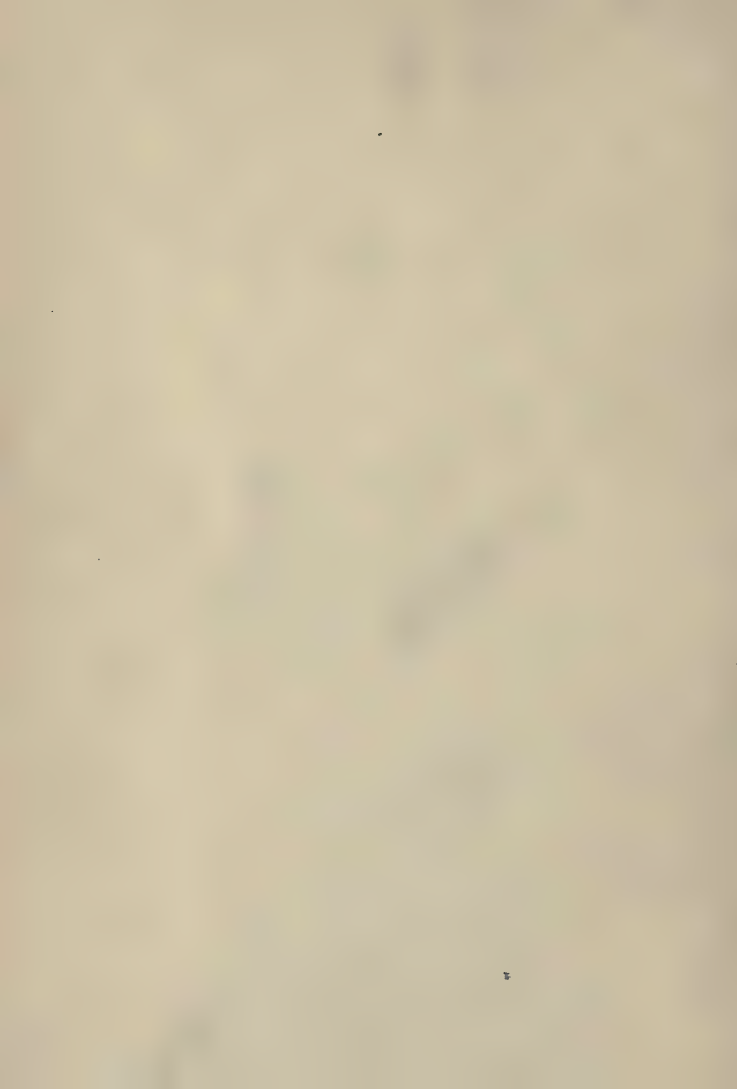
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PREFACE

IN some of the chapters of this book use has been made of relevant parts of my *Economics of Welfare* and of other publications, including a memorandum prepared for the International Financial Conference at Brussels and a pamphlet entitled *A Capital Levy and a Levy on War Wealth*. I desire to thank Messrs. Dent for kindly allowing me to incorporate some passages from my book, *The Economy and Finance of the War*, published by them in 1916.

A. C. P.

June 1921.



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CHAPTER I

INTRODUCTION

FROM the time of Adam Smith British economists have studied the working of economic processes in normal conditions. They have watched a nation of many million persons regularly clothed, fed, housed and amused, not as the result of some tremendous piece of deliberate organisation, still less by the separate effort of each person or family directly furnishing his own needs, but by an extraordinarily complex system of mutual exchange built round the motive of private money profit. This scheme of things has, of course, grave flaws ; it involves great waste ; it has meant for very many human beings weariness, discontent, hunger and pain. But the system works ! To probe the mystery of that miracle, to understand *how* it works, what exactly is the mechanism of it, and how the human forces behind the mechanism guide and control it, is a task to which able men have devoted their lives. Their hope has been that, by carrying out well and truly this task of positive analysis—this economic anatomy and physiology—

they might help other men, better trained than themselves for the practical work of government and administration, to fashion remedies or palliatives for the many evils they descry. This task is still unfinished. In one or other of its many subdivisions it is being pressed forward continually by eager students. There has, however, been a change. In the four years that ended on November 11, 1918, the unconscious processes of normal life were abandoned, and Europe swung reeling to the conscious agony of war. It is no purpose of mine to paint the unimagined horror of those fearful years. That work is for the historian and the poet of a later age. For him the clear heart, the human sympathy, the pity, the grace, the tears! For the economist these years have framed a task much humbler, but one, nevertheless, which it is right that he should try to accomplish. They have set out in strong relief, against the cool rhythm of a settled order, the strained and stressed economy of world-shattering war. What was the anatomy and physiology of that economy? How did the structures that had grown up in another environment and had adapted themselves to other ends respond to the new calls made upon them? To the Political Economy we have read hitherto there is needed a companion volume, the Political Economy of War. Some pages of this I shall try to write, partly in general terms, partly with more special reference to the experience of this country. If I succeed in any measure, some complex issues should be resolved and some confusions cleared

away. Perhaps, too, a little light may be thrown on what, if the human spirit is to remain sane and civilised society to endure, is the only political economy that will ever again have relevance to practical affairs, the Political Economy of permanent and assured peace among the great nations of the world.

CHAPTER II

THE SHADOW CAST BY WAR

1. THE Political Economy of War has two preliminary chapters. One of these deals with the shadow—the reflection in the economic structure and policy of normal times—that war casts before itself; the other with the influence which the economic structure and policy of normal times exercises in making the outbreak of war more or less probable. Let us begin with the shadow that war throws on peace.

2. First and most obviously, the menace of possible war makes necessary the upkeep of armies, navies, air forces and munition works. This involves annually the withdrawal from ordinary productive industry of a large number of men above the average level of physique, of much intelligence, of organising and inventive power and of many ingenious machines. Where conscription is in force, it may be urged in mitigation of this that one or two years' service with the forces provides some measure of general training that promotes efficiency and industry afterwards; and also that

the arrangements sometimes made for reducing the service period for young men who attain a certain standard in examinations stimulates them to make the best use of their schooldays. These pleas are urged in rebuttal of the charge that military service is, from the industrial point of view, pure waste. When a voluntary standing army is relied on, and, instead of the bulk of the population passing through the military machine for a year or so, a relatively small number of men are held to it for the main part of their lives, they are, plainly, of little force. Moreover, even under the short service system an important distinction must be drawn. It may reasonably be held that army training from, say, 19 to 21 years of age makes men more fitted for industry than they were at 19. But this is a very different thing from holding that it makes them more fitted for industry than they would have been at 21 had the two preceding years been devoted to employment in industry. Two years of military service may make a man a better carpenter than he was before the two years started, but hardly than he would have been after two years of carpentering. Thus, whatever benefit to future efficiency may result from military training is probably more than outweighed by the loss of the corresponding benefit that would otherwise have resulted from industrial experience. It cannot, therefore, properly be set against the direct loss of product that the withdrawal of people from two years of industrial work involves.

3. When service in the army, navy and munition works is voluntary, so that the pay for sailors and

soldiers must correspond roughly to that accorded to men of similar capacity in civil life, the proportion of the country's real resources annually withheld from 'production' on account of the fear of war is roughly equivalent to the proportion that the expenditure of the department entrusted with national defence bears to the aggregate money income of the nation. Of course, this is a very different thing from the money income of the government. When the Brussels Financial Conference of 1920 stated that, on an average of all the countries brought under review, "some 20 per cent of the national expenditure is still being devoted to the maintenance of armaments and to preparations for war,"¹ this did not mean that 20 per cent of the net money income of the various countries was so devoted. National expenditure was used to mean expenditure of national governments, and did not include the expenditure of people on their private needs made otherwise than through government. The figure required to give the proportion of aggregate real income or productive power that is annually used up in preparations for war would, therefore, be much less than 20 per cent. With existing statistics it cannot, even for this country, be determined accurately. Before the war, however, the money income of the United Kingdom as a whole (not the revenue of the government) used to be put by statisticians at something between 2000 and 2400 millions. The expenditure on the army and navy in 1913 was a little under £80,000,000.

¹ *Report*, p. 11.

The required figure would, therefore, seem to be between 3 and 4 per cent, that is to say, the equivalent of about a fortnight's work of the brain workers, hand workers and mechanical equipment of the country every year. For France and Germany such pre-war statistics as exist suggest that the proportion in terms of money was about the same, but it must be remembered that in conscript countries the pay given to soldiers is likely to be lower relatively to the market value of their services than it is in a country in which military service is voluntary.

4. At first sight such a figure as 4 per cent may seem surprisingly small. It must be remembered, however, that the income on which it is based is total income, and not, in any sense, surplus income. The average pre-war income per family of the 10 million householders (of $4\frac{1}{2}$ persons) in the United Kingdom was probably not more than £230. This does not leave much margin for national luxuries. As Dr. Bowley has said, "The wealth of the country, however divided, was insufficient before the war for a general high standard: there is nothing as yet to show that it will be greater in the future."¹ In the light of this fact the withdrawal of 4 per cent from the total income assumes a more serious aspect. It is equivalent to a much larger percentage reduction of the 'surplus income' that is left over after the absolutely indispensable needs of individual life—apart altogether from any need there may be for new accumulations of capital—

¹ *The Division of the Product of Industry*, p. 58.

and of government administration have been satisfied. Suppose that in the United Kingdom it was 15 per cent of this surplus income. In France, Germany and Italy, where the income per head is substantially less than in the United Kingdom and the proportion of it absorbed by essential needs higher, the figures corresponding to this 15 per cent would certainly be much bigger. The shadow of war has never involved for this country so heavy a burden of real sacrifice as it has thrown on continental States.

5. It is not, however, only in the direct cost of armed forces that the shadow of war makes its influence felt. The history of the United Kingdom affords examples of opulence having to be sacrificed to indirect preparations for the recruitment and equipping of these forces. Thus, the navigation laws, which excluded foreign merchant ships from our coastal trade, had the double object of training up in peace time seamen who could be used in war and of securing a large supply of British merchant vessels convertible at need into fighting ships. The first of these objects even now stands behind demands for limiting the employment of foreigners on British merchant ships and for imposing disabilities on alien pilots. With the divorce in structure between war vessels and ordinary ships that came about as a result of modern invention, the importance of merchant ships as potential war ships diminished; though the Admiralty still gave a subsidy to certain fast liners on condition that they should be so built as to be capable of con-

version into auxiliary cruisers. With the Great War merchant ships, in their proper function of merchant ships, have been shown to be an essential element in national defence, and there can be little doubt that, if the motive of economic profit failed to provide us with a large mercantile marine, the fear of war would compel the government to interfere by bounties or otherwise in order to divert resources from other industries into the shipping industry.

The shadow of war, which is thus liable to be thrown upon sea transport, affects land transport also. Even in the United Kingdom there is a striking example of this. The project of a tunnel beneath the English Channel, which everybody agreed was economically very desirable, was for many years vetoed upon strategic grounds. On the Continent, and particularly in Prussia, military considerations played a larger part, and the course to be followed by a number of important railway lines was determined with regard to the need of throwing masses of troops quickly to the frontier.

It is probable that transport through the air will also be twisted somewhat from a normal development by the requirements of war. The law of the air can hardly fail to have regard to possibilities of espionage over fortified places. So far as governments exercise control over the design of commercial aircraft, they will be tempted to think about the convertibility of these craft from goods carrying to the carrying of bombs. So far as they have a voice in preparing air routes and determining

the situation of aerodromes, they will not—and, indeed, they ought not to—disregard facilities for quick concentration against a possible foe and the security of repair shops and manufacturing plant from hostile air attack.

It is, of course, impossible to say to what extent the sort of defence considerations that I have hinted at are likely to injure the opulence of this or any other particular country by rendering its sea, land and air transport systems less efficient instruments of communication in normal times than they would have been if war were as dead as duelling. There is, however, a strong presumption that any interference with the free play of economic forces, designed, not to make good some failure on the part of those forces to promote economic welfare, but to forward a non-economic end, will, in one way or another, divert resources from more to less productive channels, and so will make the country *somewhat* less well-off than it would have been if the claims of defence had been silent.

6. We have now to consider a matter which is especially important to the United Kingdom—the shadow that possible future war throws upon agriculture. The United Kingdom is normally dependent for a large part of its food supplies upon imports. Some four-fifths of our wheat are obtained in this way. This arrangement has developed under the ordinary play of economic forces. It has been found that we can get far more wheat and other articles of food for a given amount of work of our men and machines if we get it indirectly in exchange

for coal and cotton goods than if we grow it for ourselves. In a world of assured peace there would be very little ground for interfering with this arrangement. There are, of course, serious social disadvantages in what is called the depopulation of the countryside ; but it is perfectly possible so to arrange things that a large part of the population live in rural surroundings, even though they are engaged in industrial, and not in agricultural, work. Where there is a risk of war, however, reliance on imported food is dangerous, because imports of food may be cut off : and, though, as recent experience has shown, it is practicable to add appreciably to the food output of the country at short notice, it is not practicable at short notice to make the United Kingdom independent, or anything like independent, of imported food. Consequently, in a world liable to war, it is a vital issue whether we should rely for our food supplies on normal economic processes or should sacrifice some of the advantages, which these processes give to us in peace, in order to provide an insurance against the risks of war. Some measure of insurance might be secured by holding permanently great stores of wheat—sufficient, for example, to supply our needs for a year—in national granaries. The same grain would not, of course, be held in these granaries continuously. What was wanted would be taken out at one end and new supplies poured in at the other. But the same *amount*, or, rather, not less than an agreed minimum amount, of grain would be held continuously. Plainly

an arrangement of this kind would be expensive, and plainly, too, it would only be effective against a short war. But, as a measure of partial insurance, some case can be made out for it. An alternative method is for the government, by bounties, guarantees or duties upon imports, deliberately to divert the productive powers of the country towards the development of agriculture instead of industry in sufficient measure to enable us to dispense, at need, with imports of food. There can be no doubt, however, that this policy, if carried far enough to be effective, would be extraordinarily costly. Moreover, since an enormously enhanced agricultural output would involve an enormously increased need for fertilisers, it might easily, when put to the test, break down; for fertilisers have largely to be imported, and in war they would be liable to be cut off.

7. Next there are to be considered certain industries engaged in the manufacture of materials and instruments which would be urgently needed for munition-making if war broke out. The iron and steel industry, the engineering industry, certain chemical industries, and the industries of iron-mining and coal-mining are of this kind. Yet again, other industries, though they do not themselves make things directly serviceable for war purposes, yet use plant that it would be possible, at need, to adapt very quickly for manufacturing such things. Thus, yards established for merchant shipbuilding can be turned over to make warships, and the plant of dye-works to make explosives. If a country relies on foreign

engineering work and foreign imports of iron ore, the cutting off of imports would greatly handicap it in maintaining its output of munitions. In the same way, if it has no works that can be readily adapted to making warships or explosives, it will be in a much weaker position for carrying on a war, should it suddenly find itself unable to import them from abroad, than it might have been. For these reasons, the fear of war may induce the government of a country, to which one or another of these industries is not naturally well suited, and in which, therefore, it would not, in the normal course of things, be well developed, to stimulate its growth by various artificial encouragements.

When a government does this, just as when it protects agriculture on military grounds, it imposes on the nation a continuing economic loss, due to the diversion of its resources into relatively unproductive channels, as a kind of insurance premium against the risks of war. If the policy is carried far enough to be effective, the costs are likely to be high and the real sacrifice involved large.

8. There remain 'key' industries. Sometimes this term is loosely used to cover all industries that are important to the economic well-being of the country—to include, for example, such industries as engineering and textiles. It seems better, however, to keep the term for industries that really are 'key,' in the sense of being small and of relatively low value in themselves, but, nevertheless, essential to enable large and important industries to work. Examples of key industries in this sense

are magneto-making, without which motor-car production is paralysed, the dye industry, which is essential to the finishing of textile fabrics, and the optical glass industry, which is similarly essential to the finishing of many scientific instruments. Some industries of the key class are keys to munition-making industries, some to industries that have no direct relation to war, some to both kinds. Their distinguishing characteristic is that the importance of their product is exceptionally large relatively to its money value. That is to say, if £100,000 worth of key goods were cut off (values being calculated at the prices ruling before the cutting off took place), the country would suffer much greater real loss than if an equal value of a non-key article, of which normally about an equal value is consumed, were cut off; for it would indirectly be prevented from using the special aptitudes of the men and machines trained to make the things to which the key goods are essential. It follows that the case for stimulating home-production by bounties, guaranteed prices or protective duties, as a defence against war risks, is much stronger as regards true key industries than as regards other industries of equal money value. When the key article is a speciality of a single country likely to become an enemy, and when, therefore, the danger that the importation of it will be completely stopped in war is great, the case is stronger than it is when there are several foreign sources of manufacture.

9. What has been said in the preceding para-

graphs should have served to indicate the nature of the problems which the danger of war raises. It is not my purpose to set out or defend any conclusion on the political issue whether or not in existing circumstances one or another method of insurance against this or that kind of shortage in war ought to be adopted by this country. What insurance premium a prudent man will pay to safeguard himself against any evil depends on a complex comparison of the effectiveness of the insurance offered, of the chance that the evil he wishes to guard against will occur, and of the amount of the injury he will suffer if it does occur. Such an issue can only be settled on the basis of elaborate and detailed study. Here we are concerned with the point of principle only. In a world liable to war it may not only happen, but it may be wise, that a country should sacrifice something of opulence in normal times in order to protect itself against a shortage of food or other essential goods should war break out. If the shadow of war were removed, this sacrifice of opulence to defence would not be required.

CHAPTER III

ECONOMIC CAUSES OF WAR

1. I PASS now to the second preliminary matter distinguished on page 4, namely, the influence which the economic structure and policy of normal times exercises in making the outbreak of war likely or unlikely. This is a large subject on which there has been much discussion. What I shall say upon it here can only be brief and summary.

2. The immediate occasions of war are manifold and, maybe, trivial—an “insult to the flag,” the murder of an official personage, the rash act of some panic-stricken commander of troops or warships, the falsification of a telegram by some astute diplomatist. But these occasions are not the causes of war. They are the match to the powder magazine. The real fundamental causes are those that lie behind the assembling of the powder. In the last analysis these are two in number, the desire for domination and the desire for gain.

3. The desire for domination for its own sake, apart from any economic advantages it may confer, is a real and effective motive for action. The

English schoolboy who asserts himself by bullying smaller boys, the German officer who bullies civilians, the white man in tropical countries who exacts special marks of respect and subordination from his 'inferiors,' all at bottom are displaying a desire for domination. There is no doubt at all that the average Englishman or Frenchman does have this sort of desire ; and, moreover, feels that it is somehow gratified by the fact that he is a citizen of a ' Great Power,' not of Holland or Switzerland or Spain. Before the war many Germans really desired their country to hold Europe in a thrall of fear, and thrilled to hear their country's sabre rattling behind its diplomacy. It does not happen, indeed, that modern nations go to war for the avowed purpose of discovering which is " the better man." But this element is certainly present in their rivalry. Furthermore, the desire for domination makes nations extraordinarily unwilling to relax their hold on any territory they have come once to ' possess.' They are ' humiliated,' outraged, dishonoured if a subject population passes out from their yoke. It is enough to name Ireland, Egypt, India, the Philippines in the days of Spanish rule, the subject nationalities of Turkey before the war, Alsace-Lorraine before the war, Finland, Poland ! For continuing to hold these places against their will, ruling powers have offered many reasons—their duty to civilisation, the white man's burden, the need for a strategic frontier, and so forth. These reasons are often put forward sincerely ; sometimes they are sound ; but, in

addition to and behind everything else, there is the will of dominant Powers to continue dominant. Against that clashes the will of the dominated to be free. There is the seed of wars of liberty, of irredentist wars, of wars of nationality! This explosive force has little to do with economics. It is outside the scope of this discussion, but it is none the less real. To ignore it and to seek an exclusively economic interpretation of war would be to neglect evident truths. The desire for gain, whose subtle workings are the subject of study here, is not the only ferment that makes for international war. It is important, in concentrating attention upon it, not to forget that the part it plays is limited.

4. Civilised nations do not go to war with one another with the avowed and direct purpose of loot. It is not, indeed, as was sometimes urged before 1914, in the nature of things impossible for a victorious nation to make an economic profit by exacting a war indemnity. An indemnity is equivalent to the wiping out of a foreign debt or to the receipt of a foreign loan on which no interest need be paid. It may, of course, happen, if the indemnity is received all at once in a form unwisely chosen, that industry will be disturbed, and incidental damage suffered in the process of adjustment. But to assert in a general way that a nation which receives an indemnity must suffer a net economic injury from it is to uphold a paradox. It will generally gain, just as an individual will gain if somebody gives him a present. So soon, however, as this is admitted, it follows that the

amount of the gain *may* be greater than the cost of the war through which it was won. This must be fully acknowledged. Nevertheless, in view of the enormous expense of modern military and naval operations, and of the chance that a war begun on a small scale may draw in other Powers, it is extremely *improbable* that there will be to any country in the end any balance of economic gain. For a government to enter on war in the hope of such a gain would be a colossal stupidity as well as a colossal crime. This is so far recognised that wars motived by the hope of loot in the form of huge indemnities are not practically to be feared. It is not in this crude way that economic influences foster modern war.

5. The traders of industrialised countries naturally desire profitable markets for their goods. Owing to the general vogue of protective and preferential tariffs they often find themselves exposed, in territories controlled by governments other than their own, to fiscal handicaps as against the citizens of the controlling governments. Consequently, as a safeguard against these handicaps, they prefer to see as large a part of the world as possible controlled by their own government. Having secured this much, they reflect that the situation would be still further improved if their government could be induced to place a fiscal handicap in the way of their competitors. There is thus in many countries a tendency on the part of traders and manufacturers interested in exportation to favour self-assertion by the government of their country in regions

where expansion or the earmarking of spheres of interest is feasible without too great risk. Manufacturers of goods, the raw materials of which come from tropical lands, may also expect a greater complaisance in satisfying their wants in regions controlled by their own, rather than by rival, governments. They, therefore, tend to back up the traders interested in exportation. When the amount of trade actually done by civilised countries with the regions of Africa and Asia controlled by them is compared with the amount done with regions politically outside the range of their influence, it is, indeed, apparent that the economic prize that merchants and manufacturers have looked for is not a great one. This is the more obvious when it is recalled, first, that the figures of exports and imports measure, as it were, the *turnover*, and, therefore, very greatly exceed the *profit* of the trade ; secondly, that the absence of national control, though it might involve a reduction, certainly would not involve the disappearance, of national trade (and the resultant profit) from controlled regions ; and, thirdly, that the manufacturing and trading activity directed to any particular market is never a net addition to the aggregate manufacturing and trading industry of a country, but is, in great part, a mere diversion of it from other markets or other products. These considerations suggest that the eagerness of manufacturers and traders to support policies of expansion in the search for markets is based on an imperfect realisation of the economic consequences of these policies. But, however this

may be, the fact remains that many manufacturers and traders do believe that political imperialism is, or may be made, a great factor in benefiting trade and industry. This belief they succeeded over many decades in imposing upon the governments of the United Kingdom, France, Italy, Germany, Russia and Japan. Since the same territory cannot be controlled by two governments at the same time, the necessary result was competition and diplomatic contests among these governments.

6. It is not, however, chiefly as agencies for promoting the trade of their nationals in relatively undeveloped parts of the world that European governments have come into conflict with one another. They have also been pushed forward towards imperialism by the influence of financiers in search of profitable concessions. Here the gain to be looked for is larger. There are openings for highly profitable investments in loans to weak governments whose officials can be bribed or cajoled, in building railways for such governments on favourable terms, in developing the 'natural resources' of oil fields, or in establishing rubber plantations on land taken from Africans and worked by the forced or 'stimulated' labour of Africans at a very low wage. When the government of some civilised country has annexed, or is protecting, or has established a sphere of influence over, any undeveloped region, these valuable concessions are apt to flow, even when they are not formally reserved, to financiers among its own nationals. These

financiers are often rich and powerful. They have means of making their voices heard through newspapers, of influencing opinion and of putting pressure on governments. In Mr. Woolf's book on *Empire and Commerce in Africa* there is a lurid account of the methods they sometimes employ. It is not my business to go through that sordid tale. All that is important here is that the desire for gain through concessions, as well as, and more powerfully than, the desire for gain through trade has impelled civilised governments into a competition for influence and control in relatively undeveloped regions of the world.

7. This competition means diplomatic backing by governments of their traders and concession-seekers in weak States, coupled at once with attempts to acquire spheres of influence, protectorates or annexations for themselves and with resistance to similar attempts on the part of others. Thus, the rivalry of the traders and financiers of different nations leads to a contest among their governments for "places in the sun." In this contest allies and associates are helpful, and so the area of contest is extended. In the background of it all stands military power. No government wants to fight for a sphere of influence or a concession for its nationals, but every government knows that, unless there is some point at which people believe that it will fight, its diplomacy will be relatively ineffective; and it knows too that, once it enters upon a game of bluff, the bluff may unexpectedly be called. In this way the economic interest of private persons,

reacting upon the policy of governments, piles up further explosive material alongside of that already prepared by desires for and resistance to, political domination.

8. Moreover, there is one private economic interest which operates in a peculiar manner. This is the private interest of makers of armaments. These persons wish to sell their goods. It need not be suggested that any among them are so callous to human suffering as to desire actual war for that end. But they certainly desire preparations for war. If they can persuade one government that another government is arming against it, they may obtain a lucrative order for ships or guns. The leading armament firms of different countries do not limit themselves to supplying the needs of their own governments, nor are they wholly independent of, or dissociated from, one another. It is to the interest of all of them to promote war scares and international competition in armaments. If they can induce one government to buy from them some new instrument of war, this of itself affords them a powerful lever with which to induce other governments to do the same. They are not without influence in the press, and, through the press, on public opinion. It is not necessary to assume that the persuasion they exercise is corrupt, or that they deliberately disseminate false alarms. It is enough to know that they find a profit in stimulating the purchase of armaments; that, so far as they succeed, mutual suspicions and mutual fears among governments are fostered; and that thus

the explosive material, out of which the flame of war may burst, is piled higher.

9. This explosive material, we may next remark, has a peculiar quality. Once piled up under the several influences I have described, it tends, like a living thing, to grow. The fear of war itself forces governments to adopt policies that make war more likely. If there were no fear of war there would be no purpose in achieving strategic frontiers. One of the objects sought in conquering African colonies, namely, the recruitment of black troops, would exist no longer. Two of the grounds for refusing independence to subject populations desirous of independence, namely, the desire to draw soldiers from them, and the desire to prevent rival nations from drawing soldiers from them and using their territory as the base for an attack, would also disappear. But the search for strategic frontiers, the absorption of uncivilised regions rich in potential conscripts, and the refusal to set subject peoples free are important factors in building up the war-like mind. Nursed by the fear of war, they themselves make war more likely and are the cause of further fears.

10. What has been said may form the basis for certain practical conclusions. Though some of the causes fostering war lie outside the economic sphere, economic causes also play an important part. These causes can be controlled by wise policy. Much was done for harmony and peace in the later nineteenth century by the use of the most favoured nation clause in commercial treaties.

It is generally recognised that a civilised State may do what it will with its own tariff, whether for import or for export. But, before the war, many States entered into widely extended contracts not to discriminate against the goods of particular foreign nations. It may be hoped that among members of the League of Nations the policy embodied in most favoured nation clauses will become universal, and, perhaps, even that some common bureau will be set up to ensure that the spirit of the policy is not violated by the imposition of duties, which, though in form general, are in fact directed only against the produce of particular countries that it is desired to injure. It is not, however, in the internal tariff arrangements of developed countries that the chief danger to peace lies. Much more important are the arrangements which these countries impose in undeveloped parts of the world under their control. Discrimination in these regions in favour of the 'mother country' is compatible with the theory of most favoured nation treatment. But it is not compatible with international harmony; and it is at the root of the eagerness of traders for their own government to extend its sway in undeveloped regions. An international agreement to do away with this kind of discrimination and to open the 'foreign possessions' of European Powers to the traders of other countries on equal terms with the traders of the possessing Power would be a great step forward. Up till the time of the war, in British possessions, as distinguished from self-governing colonies, no discrimination was

exercised (except in a single unimportant instance¹) against non-British traders. The recent imposition in West Africa of a tax on the export of palm kernels and palm oil to markets outside the Empire has spoiled this fair record, and constitutes, in the judgment of many competent persons, an evil and dangerous precedent.

II. As I have already indicated, the desires of financiers and concession-hunters in undeveloped countries are a greater danger to international harmony than the desires of traders. So long as diplomacy stands ready to back the claims of these persons, private competition in offers to lend money or build railways or run rubber estates or work oil deposits is liable at any moment to be transformed into a struggle for prestige and power between governments. Friction can, indeed, be softened by agreements to allocate specified regions to the nationals of different countries. But agreements of this kind are generally born only after long periods of discord; they threaten the allocated region with monopolistic exactions, and are liable to be disrupted by the advent of claimants from among the nationals of some State not a party to the agreement. The way out is for diplomacy to stand aside altogether, and to allow persons who wish to sink money in undeveloped regions to

¹ In 1903 the Straits Settlements gave a rebate on the export duty on tin if the tin was to be smelted in the United Kingdom. In 1916 Nigeria imposed a special export duty on tin sent outside the British Empire. Hides from India got a rebate of two-thirds of the export duty if used within the Empire (cf. Knowles, *Economic History*, pp. 353-4).

negotiate for their concessions unaided and to take their own risks of finding their debt repudiated. If they are backed by their national government, the profit they make, though a net profit to them, may easily be much more than outweighed by the extra expense in armaments that the policy of backing them forces upon the government and, through the government, on the taxpayers of their country. It would, no doubt, be difficult for one government to withdraw diplomatic backing from concession-seekers while other governments did not; but, if, under the influence of the League of Nations, all governments could be induced to do it, there can be little doubt that all would gain. It will, of course, be understood that a refusal on the part of governments to back their nationals in the search for concessions does not imply leaving the private citizens of civilised countries to do what they choose in undeveloped parts of the world. Europe owes to the natives of these places protection against exploitation by European adventurers. This obligation is recognised in the theory of mandates as embodied in the covenant of the League of Nations.

12. There remain armament firms. The danger of allowing these concerns to continue in private hands and to trade, not merely with their own, but with foreign governments also is obvious. But to nationalise armament industries is not altogether easy. If a government wanted battleships and guns and ammunition in exactly the same quantity every year, there would be no great difficulty. But,

besides actual armaments, governments also desire to have available an equipment capable of increasing their armaments very greatly and very rapidly in the event of war breaking out. The best way of securing this is to have a number of large plants accustomed to making armaments in ordinary times. This means that a far-seeing government will spread orders, so that a number of concerns, which normally make merchant ships, shall also have the habit of making warships. It also means that such a government will allow armament firms to take orders from foreign governments, so as to make it worth their while to maintain a large plant and a specially trained staff even when its own orders are small. If it manufactured its own armaments exclusively and allowed no private person to manufacture any armaments, the difficulty of expanding production in war-time would be very much greater than it is. Consequently, for a single government to nationalise the armament industry would be a dangerous enterprise. This great step away from war might, however, be taken under an international agreement.

13. So far attention has been confined to sorts of economic activity that promote conditions of war between governments. Naturally there are also important economic factors making for peace. The great nations afford very important markets for one another's goods, and people do not wish, if it can be avoided, to fight with their customers. Moreover, trade and travel and the development of means of communication promote an improved understanding of one another by the peoples of

different countries. It was the hope of Cobden and his friends that increasing freedom of trade among nations might go hand in hand with increasing friendliness and ever-diminishing danger of war. That hope has not been fulfilled, but it may still be reasonably entertained. Moreover, besides the co-operation of individual citizens of different nationalities in trade, there is also scope for ever-growing co-operation among governments in connection with economic interests extending beyond the range of single States. Of this kind of co-operation the international postal convention affords the classical example. Under the aegis of the League of Nations more and more occasions for joint economic effort may be found and utilised. If this happens, the fact of economic co-operation may be expected to stimulate the spirit of it, to lessen international rivalries and jealousies, to make possible diminished armaments, and so to lessen that fear of war, which is, both directly and through its indirect influence on policy, one of its principal causes.

CHAPTER IV

RESOURCES AVAILABLE FOR WAR

1. THE real resources possessed by any country consist of the mental and manual power of its people, of its land and mineral deposits, of its material capital of buildings, plant, railways, ships and stores of goods, of its immaterial capital of 'organisation,' and of the legal rights of its citizens to payments from foreigners. In the normal political economy of peace these various resources are conceived as being engaged with a certain rhythmic regularity in producing the national dividend, or national real income, of successive years. Economic analysis and the study of proposals for social reform, centre upon the magnitude, the distribution among people, and the variability in time of this national dividend. In stationary conditions a country's resources would, after making good the wear and tear of capital equipment, produce every year about the same volume of dividend, the whole of which, whether in the form of goods or of services not embodied in goods, would be consumed. In progressive conditions, a portion of the dividend

would take the form every year of some addition to the capital equipment, making possible the production of a rather larger dividend in the future. In stationary and progressive conditions alike a country's resources would not be worked at the maximum imaginable intensity, and would not, therefore, yield the maximum imaginable dividend, partly because people want leisure as well as things, and partly because (at least in progressive conditions) changes in the direction of demand continually call for readjustments in the machinery of production, so that it is always in some slight measure out of gear.

2. In time of war the fundamental human and material resources of a country are, of course, the same as in time of peace. But they are swung into different channels, and the centre of interest is changed. Thus, whereas in normal times we are concerned with the amount of goods and services that a country can produce regularly while its people enjoy their normal amount of leisure, in war we are concerned rather with the amount that it can squeeze out for immediate use in the actual processes of war. When the normal income-producing power of the country is given, there are four principal sources from which this amount—the real war fund, as it were—can be drawn. These are: (1) augmented production, (2) reduced personal consumption, (3) reduced investment in new forms of capital, and (4) depletion of existing capital.

3. The scope of augmented production depends upon the amount of slack, as it were, that the people

are able to take up by reduction of leisure. To begin with, in most 'advanced' countries there are a certain number of people, both men and women, who are accustomed to do no work at all, or only a nominal amount of work, to live on private means or on the earnings of other people, and to spend their lives in sport, games, social functions, travel and amusement. These people may be drawn into the ranks of active workers, whether in the army, in the hospitals, in industry, or even in taking the place of servants in their own houses. Along with them come a number of elderly persons, who, in the ordinary course of events, would have retired from industry for the closing years of their lives, but who, in fact, carry on or return to it. Some boys and girls too may be drawn into industry at an age earlier than is usual. Moreover, it is not merely by an increase in the number of workers that extra work may be forthcoming. Men and women, who are accustomed in normal times to work with ordinary intensity for ordinary hours, may work much harder and more continuously. It is, of course, true that work carried on at too high a strain or for too long hours means, not an increased, but a diminished, output, and that in the earlier days of the Great War the hours worked in munition-making industries were often unproductively long. Nevertheless, there is little doubt that many persons can, at need, do more work than they are accustomed to do in normal times, and, as a result, can produce, and continue for a long period to produce, more goods.

The additions to productive power which I have just been describing are, of course, in large part called out by the direct action of patriotic sentiment. Volunteers flow into the army and munition-makers readily accept long hours, just as a family would do which suddenly discovered its house burning and in crying need of salvage. With patriotism there may be combined direct or indirect coercion upon individuals to render a tribute of work. This coercion brings into the national store working power over and above what patriotism would send there. Direct coercion is most fully exemplified in the conscription of men of military age into the fighting forces. Indirect coercion operates through heavy taxation, either overt or concealed. This, by threatening their standard of life, may drive people to strive for larger incomes. To this end those who are in no way moved by patriotic enthusiasm may be willing to work longer hours or to step into some kind of industrial pursuit from a life of leisure or retirement. In these ways there comes about an expansion in the *supply* of work available in response to a given real price. War also promotes an expansion in the *demand* for work, in the sense of the offer of a higher real price per unit for any given quantity of work. For the government, absorbing money from the richer members of the community in taxes and loans, hands it over to men withdrawn from industry into the army. The withdrawal of these men from industry makes those that are left more valuable and makes it worth while for employers to offer

standard rates of wages to men who would normally have been left unemployed. This expansion of the real demand for labour (including soldier's work), in spite of the fact that the production of goods consumable in ordinary life is bound to be diminished, is made possible by the transfer to government through taxes and loans of things, or the equivalent of things, which richer people or foreign lenders would normally have used for themselves, but which the government now offers in payment to soldiers. The increased real demand, of course, causes more work to be done and is responsible for sweeping into industry a number of people who are ordinarily only hangers-on.

We have not, however, exhausted the ways in which industrial slack may be taken up and the volume of productive effort increased. In normal times there are apt always to be a certain number of stoppages of work due to disputes between employers and employed. These stoppages involve a loss of productivity, not merely in the industries in which they occur, but also in other industries that use the product of these industries as raw material or are otherwise connected with them : for a stoppage in one part of the machinery of industry throws other parts also out of gear. In war time stoppages of work are liable to be greatly cut down in range and importance by the patriotic desire of employers and employed to do nothing to hinder victory. They may also, if need arises, be directly prohibited by legal enactments

that in normal times public opinion would not tolerate.

Finally in normal times there is apt to be a good deal of involuntary unemployment resulting from inability on the part of the persons thrown out of their jobs by temporary fluctuations of demand to find immediately new vacancies where there is need of their services. In the later stages of the Great War the need of governments for various sorts of munition-workers was so enormous and so well advertised that anybody out of a job would know at once where one could be got. The loss of working power, that a country normally suffers through the failure of supply to chase changes in demand quickly enough, is likely in a great war to be almost wholly done away.

4. We may now turn to the second source out of which a war fund may be built up, namely, a reduction in personal consumption on the part of the people. Obviously, if people eat less, travel less, go to fewer theatres, make use of fewer servants, burn less coal and so forth, they set free resources, which are turned in normal times to satisfying their personal wants, to satisfy instead the war needs of the State. In a later chapter various sorts of personal economy will be studied in detail and their comparative effectiveness as means of augmenting the national war fund will be examined. For the present, therefore, it is sufficient to assign to them in a general way their place as one of the four main sources from which the real national war fund may be drawn.

5. At this point attention may be called to a possible confusion of thought. There is danger, in a superficial study, of regarding as *additional production* for war use something that is really a *diversion* to war use of resources normally devoted to private consumption. This mistake is especially likely to be made with reference to women's work in war time. During the Great War in the United Kingdom, as in other countries, an enormous number of women flocked into industry. Many were engaged directly in munition-making, and many in occupations—railway service, for example—from which men had been withdrawn for military service. At first sight it is natural to regard these extra women as a net addition to the productive power of the country. This, however, is a mistake. A large proportion of the women who entered industry for the war period were withdrawn from domestic service. In so far as they worked harder at munitions than they had worked in that service, the aggregate real income of the country was, no doubt, increased. But that part of their industrial activity which corresponded to their former domestic-service activity was not an addition to productive work. It was a transfer from work in the service of private consumption to work in the service of the war. Again, many of the women who came into industry had been engaged previously in work in their own homes. The services rendered by them in this work were a part of the nation's real income, and must be set against the services rendered by them in war in-

dustry, before the net addition to real income can be arrived at. A further complication is introduced by the fact that many of the men, for whom women had been managing homes, were taken into the army. As a rule they no longer needed homes managed for them, but their food had still to be cooked and other services of this class rendered. Strictly, it would seem, in order to get the net addition to productive effort due to the movement of women into industry, we ought to subtract the services rendered by cooks and other such persons within the army itself. This is, of course, a small matter. It is not, however, a small matter that a substantial part of women's industrial work in war time represented, not an addition to the productive power of the country, but a diversion of existing productive power from personal consumption to war service.

6. The third source of the real national war fund is reduction in the volume of resources turned to new investments—other, of course, than war investments. If a man builds a house or a factory or uses exports to buy a house or factory abroad, or if a public department puts up a new school or a new gasworks, resources are thereby diverted from making or serving instruments of war. Economy in making new non-war investments may permit of a very large addition to war resources, because in most advanced countries considerable new investments are normally made every year. In the United Kingdom before the war the aggregate of home and foreign investments together was

increased every year by between 300 and 400 millions sterling.

7. There remains the fourth source out of which war fund may be created, namely, the depletion of existing capital. The most obvious form of this is the direct taking over for war use of particular capital goods. A portion of a country's capital is normally in the form of stores of consumable articles held in warehouses and shops on the way from manufacturers to ultimate purchasers. These stores can be drawn upon. The wheat stock of the country, for example, may be reduced from ten weeks' supply to three weeks' supply, and so on. Besides the stores of circulating capital, certain kinds of fixed capital can also be drawn upon. For example, in the Great War the output of new railway material for service in France was supplemented by taking up and shipping to France considerable lengths of railway track from certain English and Canadian railways. Most sorts of fixed capital cannot, however, be used in this way. Houses, factories, the greater part of the country's railway equipment, its ships, its mines and mining equipment, its land and its machines cannot be turned to direct consumption, but must retain their quality of capital. Hence, the extent to which a war fund can be built up by the direct use of bits of capital is limited

There is, however, a second way in which capital can be drawn upon. Instead of taking away and using concrete bits of it, we may absorb for 'consumption' resources that would normally be

employed in maintaining it in good condition. The national dividend, or national income, as usually defined by economists, means the amount of real income available after enough has been set aside for renewals and repairs of equipment. In the United Kingdom it was estimated before the war that some 170 million pounds' worth of national effort was needed to keep the capital of the country intact. There are certain difficulties connected with this conception; but it is not necessary to investigate them here. The point to be made is a very simple one. By refraining from normal repairs and replacements, by letting railway tracks get into disrepair, by keeping old and worn-out machines at work and by taking exhausting crops from the land without equivalent replacement by adequate manuring, further resources, over and above those ordinarily devoted to producing income, can be drawn in to swell the nation's immediate economic power in the face of war.

What has been said in the preceding paragraph is applicable even to countries supposed to be completely isolated from the rest of the world. When communication with outside nations is open, the opportunity for using capital in immediate consumption is much wider. Pieces of capital, that, from their physical nature, are incapable of being turned to war service directly, can now be so turned indirectly. They can be sold to foreigners in exchange for munitions and food and other things capable of entering into immediate war consumption. Different pieces of capital differ greatly in

the ease with which this can be done. There is an important distinction between objects that can be transported outside the country to a foreign buyer and objects in respect of which it is only possible to transfer a title of ownership within the country. Gold and silver, jewellery and works of art can actually be shipped abroad if the seas are safe enough. If this is done the foreign buyer runs no risk. But titles of ownership over things that cannot be shipped abroad, whether country estates or shares in companies whose works are situated here, or the bonds of British local authorities, are in different case. A foreigner who buys these things runs the risk of finding his claim barred at the end of the war, should the nation with whose subjects he has dealt be overwhelmingly defeated. This kind of capital is, therefore, apt in war time not to find ready foreign buyers. There is, however, yet a third kind of capital that the citizens of a warring State may possess, namely, holdings of securities issued by companies in neutral countries, which are capable of making the things their government wants for war, and in which, therefore, it is anxious to obtain purchasing power. These things citizens of the neutral countries will much more readily buy, and the munitions and food purchasable with the proceeds of their sale may yield to selling countries a substantial supplement to their real war fund. During the Great War, as is well known, the dollar securities held by citizens of the United Kingdom enabled us to buy an enormous volume of war supplies from

America, not only for ourselves but also for our Allies.

Yet again, when international communication is open, it is possible for a country to turn its capital into income available for war in another sense ; namely, by creating negative capital in the form of foreign loans. These loans may be obtained in some small measure by individuals whom foreigners are willing to supply with goods on long credits ; they may be obtained by banks in the form of a deposit of balances by foreigners ; they may be obtained by a belligerent government either through individual foreign subscriptions to its issue of war loan, or by foreign loans directly negotiated with a private syndicate or with the government of a foreign country. If there is widespread fear that the would-be borrowing country will suffer overwhelming defeat, loans of this kind will be difficult to raise, for the same reason that the securities of concerns resident in the country are difficult to sell in foreign markets. In the Great War the United Kingdom and its European Allies were enabled to secure a very much larger mass of them than would otherwise have been possible, because, after the entrance of the United States into the war, there was a powerful *political* motive for granting them. From the point of view of the borrowing nation, there is evidently no great difference between selling dollar securities held by its citizens and selling its own government's promises to pay. Under the former arrangement the subsequent flow of income into it from abroad is checked ; under the

latter the subsequent flow out of it to abroad is correspondingly augmented.

8. Our analysis of the sources from which real war fund may be drawn into (1) augmented production, (2) economy of consumption, (3) economy of new investment and (4) depletion of capital may be thought at first sight to provide a straight road to a further distinction, enabling us to separate ways of providing the real war fund that hit the present only and ways that, by rendering a country's capital equipment smaller than it would otherwise have been, hit the future. Extra work and economy of personal consumption seem to be at the expense of the present, economy in new investment and depletion of capital at the expense of the future. But no such simple division is really warranted for two reasons. First, monies obtained by diversion from 'expenditure' are not wholly irrelevant to the future. There is such a thing as investment in human capital as well as investment in material capital. So soon as this is recognised, the distinction between economy in personal consumption and economy in investment becomes blurred. For, up to a point, personal consumption is investment in personal productive capacity. This is specially important in connection with children: to reduce unduly expenditure on their consumption may greatly lower their efficiency in after-life. Even for adults, after we have descended a certain distance along the scale of wealth, so that we are beyond the region of luxuries and 'unnecessary' comforts, a check to personal consumption is also a check to investment in capital

interpreted broadly, and, as such, hits the future. Secondly, that part of the war fund that is provided by augmented production will also, in some measure, strike the future. If a country at war carries extra work beyond a point, it draws in fact, though not in name, upon capital. It does this if it works any of its citizens in munition-making or other occupations with such intensity, or for such long hours, as to wear them out prematurely. It has already been pointed out that length of working day and intensity of effort carried too far defeat their own purpose by bringing about a diminution, instead of an increase, of output at the time. But there will be a stage before this, at which, though the extra hours and intensity improve output over the comparatively short period likely to be covered by a war, they damage it over the longer period covered by the working life of the people affected. This implies a using up of human capital. Again, a country may augment its available income by turning its boys and girls on to immediately productive work instead of leaving them to their normal period of school time and training. This corresponds to the device of augmenting available income by refraining from repairs and renewals of material capital: for the human capital of the country can only be kept intact if successive generations are trained up to take the place of their predecessors at a like level of educated capacity. These considerations make it plain that any attempt to distinguish with accuracy how far any fund for war has been provided at the expense

of the present or at the expense of the future would encounter formidable difficulties. Nevertheless, as a rough and practical conclusion, we may reasonably assert that, whereas resources obtained by using up existing capital or by refraining from the creation of new capital wholly hit the future, resources obtained by augmenting production or by diverting resources from the service of personal consumption are secured, at all events in large part, at the expense of the present.

CHAPTER V

REAL AND MONEY WAR COSTS AND EXPENDITURE

1. THE sum of real resources available for war, as set out in the preceding chapter, does not, of course, measure the loss that a country which becomes engaged in war may suffer. In any attempt to compute this it would be necessary to take account of the enormous destruction of values outside the economic sphere altogether—the shattering of human promise, the accumulated suffering in wounds and disease of many who go to fight, the accumulated degradation in thought and feeling of many who remain at home—which war almost inevitably involves. Moreover, even if we keep within the economic sphere, it is evident that losses may be inflicted by direct enemy action on parts of the economic body of a country that are not, and perhaps could not be, directly mobilised for war. For instance, in a country invaded by an enemy, much private property may be destroyed in the actual operations of war. In a country which is not invaded great losses may be inflicted upon many people through the interference with

foreign trade which war involves. All this must be clearly recognised. The economic resources mobilised or mobilisable for war do not bear any direct relation to the costs of war in the widest sense.

2. So much being understood, we may proceed to note that, in modern conditions, the mobilisation of real resources for war takes place under the aegis of governments, and is both depicted in and worked through the organisation of State budgets. These budgets, though they do not represent in any significant way the losses of war, do, therefore, represent mobilised war resources, or what was called in the preceding chapter the real war fund. Both the money fund that appears in the government budget and the real war fund have, however, two aspects. The money fund is at once money revenue and money expenditure: the real fund is at once real costs and real expenditure. The two sums of money are, of course, identical. But what the money, as raised, represents is not identical with what the money, as expended, represents. The real costs consist in the services and things (including leisure) that people do without in consequence of the government's demand for money; the real expenditure consists in the services and things that the government buys with the money and actually uses in war. Behind both of these lie the real resources available for war, out of which they grow. Nevertheless, they are distinct. This distinction and others closely associated with it give rise to a number of difficulties and confusions, which it is important to clear out of the way.

3. First, consider the relation between real costs and money costs. At first sight it might be thought that, whenever an individual pays over £100 to the government's money war fund, he is thereby necessarily shouldering £100 worth of the real costs of the war. This, however, is by no means so. A large part of the money paid over by particular individuals to the government represents, not real costs borne by them, but real costs thrown by them on the shoulders of other people. Thus, suppose that a man obtains funds to pay his taxes or subscriptions to war loan by cutting down gifts and charities or by reducing payments to employees whose services are still retained. A person who 'economises' in these ways does not really economise at all, and does not himself hand over any real resources for the service of the government. What he does is to throw the task of meeting the requirements of government upon somebody else. If he reduces an old servant's pension by £100, this old servant has somehow (unless he, in turn, can pass the task forward to some one else) to work harder, to economise, to refrain from new investment, or to use up capital, to the extent of £100. The original 'economiser' has shouldered no part of the State's burden; he has merely transferred the obligation to do this. In like manner, if a man sells securities in his possession to a fellow-citizen and pays taxes and war loan instalments out of the proceeds, what he has done has been to part with a property right in order to induce somebody else to undertake the task of working harder,

or economising in consumption, or refraining from investment in new real capital, or 'using up' real capital by selling it to foreigners or otherwise. He himself has done none of these things. He has acted as an intermediary, not as a principal, in undertaking the real costs that his money payments represent. The same thing is true if he obtains the money he hands over to the government by borrowing either from private persons or from banks resident in his country. Finally, the same thing is true, up to a point, when people provide funds for taxes and war loan subscriptions by reducing their consumption of articles—tobacco, wine, tea or sugar—a part of the price of which is made up of customs or excise duties. Suppose, for example, that a man meets an income-tax claim for £60 by cutting his expenditure on these things by that amount, and that this involves a reduction of, say, £20 in his payment of indirect taxes. In these circumstances he has cut down his total tax payment from £60 to £40, and, therefore, if the aggregate revenue required by government is decided upon, has made it necessary for other taxation to be imposed on other people (and himself) sufficient to fill this gap. Abstinence from dutiable articles, therefore, constitutes, so far as the duties included in their price are concerned, not a provision, but a shifting, of so much of the real costs of war.

4. Secondly, consider the relation between real war expenditure and money expenditure. It is often thought that, since the latter of these 'represents' the former, it may be used unconditionally

to measure it. This opinion ignores the fact that the aggregate money price expended on real resources may be altered, not only by a change in the quantity of real resources bought, but also, alternatively, by a change in the price that is paid for each unit of them. On this error large structures of fallacious reasoning have been built up.

Thus, it is widely believed that the real expenditure to a people of waging war is greater or less according as the rate of pay to its soldiers is high or low, and according as a large or small amount of money has to be paid in respect of their dependents. In 1914 many people argued that Germany could conduct the war more cheaply than we could because her soldiers, being conscripts, received a much lower rate of pay than ours did. Again it was, and still is, believed by many people that, because married men have dependents, to whom separation allowances must be made when the men go into the army, whereas, in general, single men have not such dependents, a married soldier involves much more real expenditure to the nation than a single soldier. But the real expenditure involved in the maintenance of the army is the expenditure of the services of the soldiers. Hence, the rate of pay given to them does not *directly* affect the real expenditure of the nation in any degree. If more is paid to them than they would normally earn, a certain transference of resources is made from the rest of the community to them; if less is paid to them than they would normally earn, a certain transference is made from them to the rest of the community.

The aggregate real expenditure on the war of them and the rest of the community combined, that is to say, of the country as a whole, is the same in either event; it is equal to the sum of the services which they render.

A second form of the same fallacy often appears in arguments about government extravagance. In many of these arguments every form of alleged extravagance is lumped together under the same head, and it is tacitly assumed that the face value of the extravagance always represents the real expenditure that it involves to the nation. For example, the alleged extravagance of continuing to pay £400 a year to Members of Parliament, of paying exorbitant prices to contractors or exorbitant wages to work-people, of taking troops to some place at heavy cost and then taking them back to the place from which they came, of making immense quantities of a certain kind of shell which is afterwards found to be useless—all these things are supposed to be exactly similar in character and effect. This is incorrect. From the money standpoint of the Treasury, it is, of course, true that they stand upon the same footing. They all deplete the government balances and make necessary the raising of more money. From the standpoint of the community as a whole, however, they comprise two quite disparate kinds of extravagance, the effects of which are wholly different. To make masses of shells of a kind that we do not want is a real waste of capital and labour: to transport troops from Egypt to the Dardanelles and then to

transport them back again, because the ships were not properly packed, is also a real waste. But to pay a man, whether he be a Member of Parliament, or a contractor, or a workman, much more than his services are worth, that, undesirable though it is, does not directly involve any waste of national resources. It is merely a transference of resources to one set of people in the country—payments made to foreigners are different—at the expense of another set. Of course, if the people from whom the money is taken to make the transference would otherwise have put it into war loan, whereas those to whom it is given use it in unproductive personal consumption, the country's power to carry on the war is indirectly weakened. Of course, too, large money payments by the government for services rendered to them mean large borrowings and, consequently, a large national debt and the fiscal complications associated therewith later on. In view of these things, it would be ridiculous to contend that large money expenditure due to excessive payments made to contractors and work-people do not matter. They matter a great deal. But—and this is the thing with which we are now alone concerned—they do not represent directly any addition to the real expenditure involved in waging war. In the same way, if the government commandeers the services of men or buildings for less than their market worth, or even for nothing at all, this, while lowering the money expenses, does not directly affect at all the real expenses of the war.

5. Lastly, consider the relation between real

costs and real expenditure. The services and things (including leisure) that people do without in order to meet the government's money demands on them are not identical with the services and things that the government buys in order to carry on war. What private people do without consists in pleasant food, the work of domestic servants, new houses, new motor-cars, petrol, convenient travel, new factories, new clothes and so forth. What the government gets consists in the services of soldiering and of manning ships of war, together with immense masses of guns, shells, aeroplanes, tanks, poison gas and explosives. If there had been no war, the great bulk of these things would not have come into being at all. They are, and are bound to be, quite different from the things that would then have come into being. This distinction provides the basis for certain practical inferences that will be developed in the next chapter.

CHAPTER VI

THE CHOICE AMONG PERSONAL ECONOMIES

1. As was pointed out in Chapter IV., one of the sources out of which the national war fund may be built up is personal economy in consumption by private people. At first sight we might suppose that, when once the public had decided to economise by cutting down its consumption by a given money value, say a million £, it would be a matter of indifference to anybody other than the individual economisers what particular sort of purchases they decided to cut down. The analysis of the preceding chapter has, however, prepared us to see that this is not so. The productive powers released from private service by different sorts of million £ economies are not all equally well fitted to furnish the sort of things that governments need for war. This important point is well illustrated by a comparison of two extreme examples. First, suppose that the public are accustomed every year to buy a thousand £'s worth of shells and to explode them for amusement in a barren place. If they decide in war time to dispense with this luxury, the

productive powers they thereby release from their service are free to make an equivalent mass of shells for the government; and shells are things that the government greatly wants. Secondly, suppose that the public are accustomed to spend a thousand £ in purchasing exquisite unexportable hand-made lace manufactured by people who are unable to do anything whatever except make this lace. If they decide to dispense with this luxury, they release from their service productive powers, which, *ex hypothesi*, are incapable of contributing anything whatever to the war needs of the State. On the supposition then that the shells and the lace occupy similar positions in the scale of people's wants, both economies will involve about the same sacrifice of private satisfaction, but one will help the war fund greatly, the other not at all. Extending the line of thought that these illustrations suggest, we readily conclude that, other things being equal, different sorts of economy on the part of the public are more or less effective means of helping to win a war, according as the productive powers they set free from private service are more or less well fitted to produce things that the conduct of war requires. The practical implications of this principle may conveniently be set out in two divisions, according as they affect purchases of direct personal services or purchases of commodities.

2. First, it is quite plain that in war time the services of doctors, of men of mechanical knowledge, of chauffeurs and of young able-bodied men fit for military service and not possessing any specialised

skill are, relatively to the price commonly paid for them, of great value for war. On the other hand, the services of lawyers, of highly skilled gardeners, of poets, of men learned in the ancient languages, of musicians, of actors, of young men medically unfit or with conscientious objections to combatant service, of midwives, of women with special skill as children's nurses, of ballet dancers and of music-hall artistes, are, relatively to their price, of very little value for war. Therefore, other things being equal, people will make a more effective contribution towards victory by dismissing chauffeurs, young men servants, and women servants without specialised training but physically fit for industrial work than by dismissing other (and probably older) servants, whose value is chiefly due to specialised quality of little utility in war—a highly skilled flower gardener, an artist in cookery, a nursery maid or governess exceptionally skilled in her chosen task but inept at handling material things, a court musician or a court jester.

3. Secondly, consider purchases of commodities. There are certain things that are wanted by government in exceptionally large quantities for the use of its armies—things such as gunpowder, petrol and meat. These are obviously good things in which to economise. Then there are things made out of materials essential to war needs, economy in which sets free these materials. Examples are articles made of leather, wool and steel. Again, there are things made by the same kind of machines and work-people as are required for making things

essential to war needs. These include the products of engineering works and the plant required for setting up war factories. Yet again, there are things the acquisition of which involves the use of ship space and train space that are in great demand for military ends. *Pro tanto* these things—imports from overseas, such as oranges and bananas, and articles the raw materials of whose manufacture are largely imported, such as beer—are suitable objects for war economy. On the other hand, there are a number of commodities, which are not useful for war purposes and the value of which is not to any substantial extent due to material, plant, labour or transport services useful for such purposes. These things are, in comparison with the others, unprofitable objects of war economy. Among them should be included ball-dresses and similar costumes made in England, the value of which principally depends on highly specialised work of a kind for which war has very little use. There should be included, too, water, as supplied by a water company to a town, and, in lesser degree, gas and electric light. Finally, there should be included the services rendered by museums and art galleries. In these institutions and their collections there is embodied an enormous capital plant quite useless, or nearly useless, for rendering war service. If, as a result of our economies, they are shut down, their staffs may, indeed, be utilised in war, but the public loses, not only the use of their staffs, but also the use of the capital establishment of the institutions ; and that loss is balanced

by no corresponding gain to the government's war efficiency.

4. These results lead at once to the ethical problem of private duty. In view of the fact that certain sorts of economy on the part of the public are more effective aids to war than others, what ought the patriotic public to do? It is important that there should be no confusion about the precise issue here. The preceding discussion has made it plain that several sorts of luxury goods are less advantageous objects of economy than the bulk of necessary goods. The issue is not whether, in view of this fact, a rich man may properly continue to buy ball-dresses in war time. He ought not to buy ball-dresses, because, by refraining from doing so, he can cut his aggregate expenditure down lower than he could do otherwise. The issue is: given the amount of the cut to be made in his aggregate expenditure, would he do better to take £100 off ball-dresses or off bread? The hasty answer, of course, is that every one ought to concentrate entirely upon the sorts of economy that are most helpful towards victory. But this answer is not correct. With sufficient knowledge it should, indeed, be possible, on the basis of what has been said, to draw up a kind of order of merit among different sorts of economies from the point of view of their comparative effectiveness. But this order of merit cannot be used as a direct criterion of private duty. People's duty depends, not only on the comparative usefulness to the State of different sorts of economy, but also on the comparative

sacrifice to themselves that different sorts involve. In general, the last shilling that they choose to spend on one thing may be presumed to yield them about as much satisfaction as the last they spend on another thing. But on all things the earlier shillings are likely to yield them much more satisfaction than the later shillings. Hence, it will, in general, hurt them much more to concentrate their economies upon a few things than to spread them over many. People, therefore, have no duty to select the economy that stands first in our order of merit, to stop completely their purchase of that, and to proceed in the same way down the list till the whole reduction in expenditure that they intend to make is accomplished. Nor have they necessarily a duty even to knock more expenditure off a thing high up in our order of merit than off one lower down; for, if the one high up is something for which their demand is highly inelastic—bread, for example—a tenth £ knocked off that will mean a much bigger sacrifice for them than a tenth £ knocked off something for which their demand is elastic. They have a duty, however, to push their economies in things high on the list rather further, and on things low on the list rather less far, than their personal preferences by themselves suggest. *To what extent* they ought to do these things could, of course, only be determined on the basis of a full knowledge of all relevant details.

5. Moreover, the issue is complicated by a distinction that must be drawn between the duty of a

single individual and the duty of a group. If a single individual, who has to cut down his aggregate expenditure by £1000, on patriotic grounds cuts his consumption of petrol 10 per cent more, and his consumption of music 10 per cent less, than he personally likes to do, the price of petrol will be put a little lower, and the price of music a little higher,—from the short period point of view relevant to the war—than they would have been put otherwise. Consequently, other people will buy a little more petrol and a little less music than they would have done; and his patriotic action will thus be robbed of its full effect. How far the good he tries to do will be cancelled in this way depends on the nature of the demand and supply of the commodities concerned. If the demand is highly inelastic, there will be very little cancelling: if it is highly elastic there may be a good deal. But, if there is any cancelling at all, for one out of a hundred individuals to cut off his petrol consumption (in preference to his music consumption) in a given degree helps the government less than one-hundredth as much as similar action on the part of the whole hundred would do; whereas, if the individuals are all similar, it involves exactly one-hundredth as much loss of private satisfaction. It follows that, as with such things as the Sunday closing of shops and limited hours of work, it may be the duty of the community as a whole, acting through its government, to enforce upon all its members a more stringent selection of economies than it would be the duty

of any one of them acting alone on his own initiative to make.¹

6. Three forms of government action are possible : propaganda, the imposition of duties on the purchase of things the private consumption of which it is especially desirable to cut down, and direct restriction of individual purchases. The method of propaganda does not call for study here. Its general character is obvious and its detailed application the concern of political technicians. The method of duties cuts off from each purchaser an *amount* of consumption which varies with the amount of his normal purchases coupled with the elasticity of his demand. If the demands of two

¹ Analytically, the basis of this argument can be developed as follows:—Let there be n similar purchasers of a commodity. Let the quantity consumed by each be A and the elasticity of the demand of each $-\eta$. Let the elasticity of supply of the commodity be e , and let this be positive. Then, if one of these purchasers cuts down his consumption from A to nothing, it is easily shown that the reduction in aggregate consumption will be, not A , but, as a first approximation, $A \frac{ne}{ne - \eta(n-1)}$. Obviously, if $-\eta=0$, this is equal to A : if $-\eta$ is infinite, it is equal to nothing.

It may be observed, in passing, that a corresponding formula can be obtained for the aggregate effect upon *production* of the addition or withdrawal of the output of any one producer. Let A now represent each individual's production, e the elasticity of his supply, and $-\eta$ the elasticity of the general demand. Then the aggregate effect of the withdrawal of A units by one producer approximates to

$$A \frac{-n\eta}{-n\eta + (n-1)e}$$

If $-\eta$ is very large and e is small, this approximates to A : in converse conditions it approximates to nothing.

persons are equally elastic, the cuts from them will be proportioned to their normal purchases. The method of direct restriction will be examined in detail in a later chapter. When it takes the form of maximum rations, it cuts down the consumption only of those persons who used to consume more than the permitted ration. The method of duties has the advantage that, as between two equally rich people, one of whom has an inelastic demand for one thing useful for war, say petrol, and the other an inelastic demand for another thing of similar usefulness, say steel, it allows the first man to make a bigger cut in petrol, and the second a bigger cut in steel, instead of forcing, to the common injury, equal cuts, or equal rations, in each of these things indifferently on both of them. As between two persons of different wealth purchasing the same thing it is, however, less satisfactory. In the first place, as is well known, all specific duties upon commodities of wide consumption tend to strike poor people very heavily as compared with rich people, because they do not take account of differences of quality. There is, therefore, a danger that a large use of the method of duties would involve an unfair burdening of poor people. This danger could, no doubt, be obviated by a judicious compensating arrangement of direct taxation. But, in the second place, there is a danger that, even if the aggregate tax burden thrown upon poor people is not made unduly large, poor people will be forced to divert their consumption away from the particular things subjected to duty to an extent that injures

them more than it helps the government. The method of direct restriction, on the other hand, can be applied in such a way as to leave the consumption of really poor people untouched. This is a strong argument for the method of direct restriction, even when government control over prices is not attempted. When control is attempted, the method of duties is obviously not applicable, and the method of restriction alone is in the field.

CHAPTER VII

GOVERNMENT COMMANDEERING

1. IN the preceding chapter it has been made clear that, when a government has got hold of a given volume of purchasing power, the mass of things and services useful for war, which it will be able to obtain with it, will be greater, the more the public economises in the purchase of these particular things. It has been indicated that the sort of economy desired can be stimulated by propaganda, the imposition of duties, or some form of direct restriction upon private purchases. It has now to be observed that there is also available another method. Instead of, or in addition to, putting pressure upon private people to divert their consumption from services and things which it wants, the government may, by direct process, assure to itself its own requirements of particular things and services, leaving to other people only such balance as may remain over after those requirements have been satisfied. There are several ways in which this can be done. It will be convenient to consider them, first, as applied to flows of annually

produced goods, and, secondly, as applied to stocks of productive instruments and agents.

2. For flows of annually produced goods the most effective device is for the government to make itself the sole dealer, to reserve for its own use what it requires, and, thereafter, to arrange a plan for distributing among the public what is left over. When the commodity is produced at home, the government can possess itself of the whole supply by commandeering, and it is open to it to fix the price that it will pay at what it considers reasonable, subject only to the knowledge that, if it fixes it too low, supplies may dry up. Thus, the British Government took over for several years, at an arranged price, the whole of the wool crop of the country and the whole of the wheat crop. It also commandeered all available timber supplies. For imported commodities government is, of course, less free to fix its own purchase price, because it cannot compel foreigners to sell to it. But, by forbidding its citizens to trade in certain foreign goods, it can, none the less, make itself the sole dealer. The British Government did this for imported wool, for jute, leather, numerous metals, and, by the end of the war, for practically all the common articles of food. It kept what it wanted for its own needs, including, of course, the provisioning of the army, and, by means of priority certificates and rationing, arranged for the distribution of the balance. These methods of distribution will be studied in later chapters.

3. In so far as a government wants for war exactly the same classes of goods that civilians

normally want in peace, pretty much all that is necessary can be done by dealing in the way I have been describing with the annual inflowing stream of production. In fact, however, a great part of the war needs of governments differs from the peace needs of civilians. Consequently, as has already been explained, what is wanted is, not merely a transfer of certain things from civilians to government, but also a transfer of productive resources from certain employments to certain other employments. There is thus an opening for commandeering productive instruments and agents. Of this there are two degrees. First, the whole of any particular sort of instrument or agent may be commandeered; secondly, only such proportion of it as the government wishes to turn directly to its own service may be commandeered. The first sort of commandeering was applied in the United Kingdom immediately on the outbreak of war to the railway system of the country, and, later on, it was applied to the engineering plant of the country, the coal mines and the flour mills. In the earlier part of the war, the second less complete form of commandeering was applied to the mercantile marine, a certain number of vessels being requisitioned by the government at blue-book rates, while the rest were left to the free use of their owners. Later on, however, practically the whole of the mercantile marine was commandeered.

4. So far attention has been confined to productive *instruments*. Productive agents also were commandeered under Conscription Acts. All fit

males of military age, other than those exempted on some urgent ground, were compulsorily enlisted in the army. There was talk at one time of extending this method to persons other than males of military age and for purposes other than military service. In the United Kingdom the strong dislike felt by manual workers for anything that could be called industrial conscription prevented this from being done. But the right to compel men of military age to join the army was used as a lever to divert those who were not so taken into the channels along which government desired labour to flow. Lists were made of 'non-essential' occupations, into which men of military age were not allowed to go without the leave of the Minister of Munitions, and, over against these, lists of essential occupations into which they were directly urged to go in the national interest.¹

5. For home-made commodities or the services of instruments or agents of production resident here, commandeering can accomplish what no system of limitation of private people's purchases can do. It can cut off the rival demand of foreigners. For example, before the war a large part of the British mercantile marine was engaged in the carrying trade, outside of this country altogether, between certain foreign countries. It would not have been possible to rope in the services of these ships for things helpful to the war merely by forbidding British citizens to make use of them.

¹ Cf. Hammond, *British Labour Conditions and Legislation during the War*, p. 131.

They might still have gone on working for foreigners. So, too, might a number of British engineering firms and makers of woollen goods. Of course, the government, instead of commandeering or controlling ships or factories, might have prevented them by direct order from working for foreigners. But, once this sort of control is introduced from the side of production, as distinguished from the side of purchase, some steps on the way towards commandeering have already been taken.

6. Again, for home products and domestic instruments and agents of production, a policy of commandeering has the advantage of permitting a limit to be set on the prices that producers are allowed to charge. To limit price in sales to government alone without commandeering would inevitably drive sellers away from government : and to limit price to other purchasers as well as to government without commandeering would subject government to great uncertainty as to how much of the things it wanted it could obtain, because, as will be shown presently, for commodities produced under competitive conditions, an effective limitation upon price renders distribution the sport of accident. If, however, price limitation for things in large government demand is impracticable apart from commandeering, this constitutes a strong argument in favour of commandeering. In a minor war, the material and human requirements of which are small, the damage resulting from failure to limit prices is not likely to be grave. But in the world war, had the government been forced to buy all

the services and things it needed in a free market, people in a position to sell to it could have demanded terrifyingly high prices, and so secured, at national expense, fabulous profits. It is true, as was pointed out in Chapter V., that this would not have meant directly any addition to the real expenses or real costs of the war : for these consist in services and things, not in the payments made for them. But it would have meant an enormous addition to the money expenses of the war, and this would have involved probably a further expansion of credit and currency, and, certainly, a great increase in the national debt. Both these things, as will be shown in later chapters, have a very evil aftermath.

7. The dominating advantage of commandeering is, however, different from anything mentioned so far. It enables the transition from peace production to war production to be effected much more speedily than would be possible without it. A policy confined to collecting purchasing power from the public and spending it on things needed for war would not achieve its end quickly. The transition that has to be made from one set of industrial operations to another is very large. If the government relied merely on financial methods, it would offer, out of the purchasing power in its hands, higher prices than ruled before for the things it needed, while the prices of things with which private persons dispensed in order to provide money for their taxes and loan subscriptions would tend, in consequence of the diminished demand, to fall. The resultant increased profitableness of

producing the sort of things government wanted and diminished profitableness of producing other things would cause a change-over of productive resources from other things to government things. This is the general process of industrial transition in response to changes in the flow of effective demand. Such a process is bound to be gradual. People and capital equipment will not be shifted across at once from the depressed to the expanded forms of production. Friction, the general tendency to procrastination, imperfect knowledge of present facts and future prospects, all will hold them back. Many manufacturers, for example, of things not wanted for war, thinking, as they are sure to do, that the war will be short, will hesitate to adapt their works and train their work-people to new tasks; they will keep them to the manufacture of their former products, with the idea of holding these in stock until peace returns. Yet again, work-people who used to make non-government things, on being thrown out of employment through the contraction of demand, will tend to stay where they are, instead of moving to other employments which are booming, in the hope of a rapid return to normal conditions. Finally, when the effective manufacture of government things requires special training in new processes to be given to work-people or special plant to be set up, private enterprise, even if it is tempted to provide these things at all,—which, in view of its knowledge that the war may end before they have yielded their profit, is doubtful—is sure to provide them slowly. In an intense

international conflict, however, delay is extremely dangerous. Time is of the essence of victory. The moulding of industry into the shape proper for war will need, therefore, if the conflict is severe enough, to be helped forward by direct government coercion of industry.

CHAPTER VIII

TAXES *VERSUS* LOANS

1. IN normal times the resources needed by government, apart from the payments made in fees for postal or other direct services, are obtained through taxation. In a well-ordered State, for *ordinary* expenses there is no question of any other arrangement except as a purely temporary makeshift. For government to continue, as a regular practice, to finance part of its ordinary charges by borrowing would mean the piling up of an ever-growing debt, such that the annual interest alone would eventually exceed the annual expenditure on behalf of which it was incurred! It is, therefore, a generally accepted canon of sound finance that ordinary expenditure—the assistance of poor persons, the upkeep of schools, the maintenance of the army on a peace footing, and so forth—must be financed by taxation and taxation alone.

2. When exceptional expenditure has to be undertaken it is common for governments to resort to loans. If the expenditure is remunerative, in the sense that it is expected to yield a money return

adequate to pay interest upon it at the normal rate, loans are resorted to exclusively. If, however, the expenditure is not remunerative, while at the same time it is exceptional and non-recurrent—expenditure, for example, that is incurred in pulling down a slum area—the issue between taxes and loans is less clear. Of this type of expenditure war expenditure is much the most important instance.

✓ The question how far such expenditure should be financed out of current taxation and how far out of voluntary loans has been the subject of prolonged debate and was vehemently discussed in many countries during the progress of the Great War.

3. On two points there is, in this country at least, fairly general agreement. First, if and in so far as loans are employed to finance war, new taxation ought to be imposed at the same time at least sufficient to provide the interest incurred under the loans.) For otherwise not only is confidence in the financial stability of the State liable to be wrecked, but also the conclusion of the war would be followed by the paradox of increased, rather than, as the public would naturally expect, diminished, taxation; and this would lead to great discontent. Secondly, at all events in a war on the scale of that which recently closed, it is generally agreed that a policy of finance through taxation alone, however excellent it might be in theory, is in practice out of the question, for the simple reason that people would not stand it.) Hence, the phrase *taxes versus loans*, with which this chapter is headed, suggests a sharper antithesis than we really have to face. In

a great war there must, in all ordinary circumstances, be both some new taxation and some loans. The extent to which resort should be had to one or other of these things cannot be determined without detailed reference to current economical and psychological conditions. All that can be attempted here is to set out in a general way the relevant considerations.

4. At the outset it is necessary to clear away a current confusion. (It is widely believed that, in so far as war is financed out of taxation, the economic burden involved in it is borne at the time, whereas, in so far as it is financed out of loans, the burden is thrown forward on to the future.) This is a misconception. No doubt, when a warring government borrows from abroad, its citizens escape the need of making real payments now, in exchange for pledging themselves and their descendants to make them later on. But (the main bulk of war loans are necessarily raised at home.) As between these domestic loans and taxes there is no such clear-cut contrast as public opinion supposes. In Chapter IV. the several sources out of which the real war fund of a country must come were enumerated and distinguished. It was shown that resources obtained by extra work and by economies in personal expenditure come, in the main, out of income and hit the present only, whereas resources obtained by refraining from new investment, by letting equipment run down, by selling property to foreigners and so forth come out of capital and hit the future. When a given sum of money is raised by the government from anybody, and he does not shift the task

of shouldering it on to somebody else, the choice that he makes between these various sources is not determined by the form in which the levy is made upon him. It is open to him to meet the claims of taxation out of capital and those of loans out of income. The size of the contribution he is called upon to make is a much more important factor than the form of it in determining the sources from which he elects to provide it. ✓

5. It does not follow from this, however, that the choice which the government makes between taxes and loans has no effect at all upon the choice the public make between drawing upon income and drawing upon capital. The question, what, if any, effect the government's choice does in fact produce, is an interesting one and deserves to be studied in some detail. ✓ Let us begin by supposing that the loan contemplated as an alternative to taxation is not a voluntary, but a forced, one, and that it will take from each individual exactly the same sum as, under the rival plan, would have been taken from him in taxes; and let us suppose further that each lender is given to understand that, of the taxation required to pay interest and sinking fund on the government debt created by the loan, he will have to provide a proportion exactly equal to his proportion of loan-holdings. It is possible to imagine a world in which the levy of a forced loan on these terms would have the same effect as the collection of an equal sum of money by taxation. To tell a man who expects to live for ever, in a country where the rate of interest is always 5 per

cent, that he must surrender £1000 now, is approximately the same thing as to tell him that he will have to surrender £50 a year from now onwards for ever. Or, to put the point otherwise, to take from him £1000 now in taxation is approximately the same thing as to borrow from him £1000 on a loan of 5 per cent, at the same time informing him that the £50 interest to be paid on his loan will be collected every year by that amount of taxation levied on himself. I have said that these two things are *approximately*, and not exactly, the same, because the loan plan would leave the £1000 in our citizen's possession and thus available to fall back upon in an emergency, while, on the tax plan, he would be deprived of this stand-by. But, if we carry our supposition further and abolish all economic friction, it will appear that our citizen could not make use of his £1000 for an emergency without sacrificing £50 a year in interest afterwards, and—always apart from economic friction—if he were prepared to do this, he could, on the rival plan, borrow £1000 for the emergency. On these suppositions the two plans would work in *exactly* the same way, and no one who understood what was being done would act otherwise if confronted with the one than he would do if confronted with the other.

6. Let us now return by degrees to the actual world: and, first, let us reintroduce economic friction. What this means from the present point of view is that, when a person has collateral to offer, even though he is subject to extra taxes equivalent

to the interest on the securities which this represents, it is practically very much easier for him to borrow from bankers, not merely in an emergency, but on any occasion, than it would be otherwise. He is, therefore, likely to consider himself *slightly* more hurt by a tax than by an equivalent loan : and he may, in consequence, make slightly greater efforts to meet the impost by harder work and by economy of consumption. In view, however, of the fact that most people rich enough to be subject to large levies have already ample securities, which, at need, they can pledge or sell, this effect is probably too small to need serious attention.

7. A more important consideration is as follows. In practice, when a man is forced to lend £1000 at 5 per cent, it is not possible to decree that the £50 required annually to pay him his interest shall be taken in taxes from himself. The tax system may be designed to effect this object, and may succeed in effecting it at first. But taxation cannot be worked by way of poll taxes ; it must be based on some objects—income, expenditure, commodities or what not. Hence, whenever any given amount of future taxation has to be provided for, the portion of it that will fall on any particular individual cannot be determined beforehand. It will depend roughly on the ratio at the time between his income and the aggregate income of the community, and this ratio is liable to be modified, not only by what he does, but also by what other people do. The tax method of raising money, therefore, means to any citizen the loss in after years of the interest

that he would have received on the money he is forced to give to the government: the (forced) loan method means the loss in after years of an amount of taxation, which may exceed or fall short of this sum, according as his income comes to constitute a larger or a smaller proportion of the aggregate national income. This necessary looseness of connection between the loan burden and the future taxation that a lender will have to meet towards providing his own interest leads to too little attention being paid to the debit side of the account under the loan method. People in general may, therefore, be expected to think themselves *considerably* less hard hit under the loan plan than under the tax plan. Consequently, they will be appreciably less keen to meet the call upon them by economies in consumption and increased output of work. So far as this happens, the capital of the community will be depleted appreciably more under the loan plan than under the tax plan, and the real income of the country accruing in future years will suffer in proportion.

8. Hitherto we have supposed the loan plan to be carried out by way of a forced loan taking from each citizen exactly the sum that would have been taken from him under the tax plan. In actual practice, however, loans are generally voluntary, and large subscribers have good reason to hope that the interest on their holdings will exceed the contribution in taxes which they will have to make to provide this interest; for experience has never yet revealed a tax system graduated for increasing

incomes anything like as steeply as loan subscriptions are likely to be graduated, at all events when the loan required is large. Hence, the richer classes, from whom, when a large amount of money is wanted, contributions under any plan must chiefly come, will think, and rightly think, that a loan hits them much less hardly than equivalent taxation would do. They are, therefore, less likely to be induced to check consumption or to work more strenuously, and more likely to subscribe to government only such resources as they would otherwise have invested in industry. Consequently, the check to the provision of work and capital will be more serious. It appears, therefore, that the popular instinct is in some measure justified. Finance by loans does hit capital and, through this, the economic fortunes of future generations *somewhat* more hardly than finance by taxes.

9. Moreover, it is not only through the immediate impact upon capital that loans made now press upon succeeding years. Finance by taxation means a single levy and, thereafter, nothing. Finance by loans (whether voluntary or compulsory) carries with it, unless the strong remedy of a capital levy is applied, a prolonged aftermath of taxes to pay interest and sinking fund on the loans. It is true that these taxes, being paid over to domestic holders of war loan, will represent merely transfers of purchasing power within the country, and not any using up of real resources. But, though they will not directly absorb real income, they will, none

the less, indirectly lessen the volume of real income that comes into being. For, being long enduring and foreseen, the expectation of them must, as will be argued in detail in Chapter XVII., in some measure check industry and saving so long as they last. The raising and spending of large loans in war time may, therefore, when indirect as well as direct effects are taken into account, hit the future with considerable severity. This is an important result. It does not, however, constitute a decisive argument against finance by loans. It would only do that if all hitting of the future were necessarily bad: and many people hold that, since wars are waged, partly at least, for the benefit of the future, the future *ought* to bear a substantial share of the burden they involve.

10. A second relevant consideration in the choice between taxes and loans is their comparative effect in leading to an expansion of bank credits, and so to a general rise of prices. In Chapter X. the policy of credit creations on behalf of government as a means of war finance will be examined, and will be shown to lead to many undesirable consequences. Exactly the same consequences will follow if, instead of the credits being created directly for government, they are created for private persons who use them as a means of making the payments to government that are due from them. Now, both under the tax system and under a loan system it is possible for people to resort to credit creation to some extent. There is reason to believe, however, that, if a given sum of money has to be contributed

to the government, the contributor is likely to resort more largely to credit creation for a loan payment than for a tax payment. The reason is partly that, as already indicated, under the loan method he does not feel himself to be so hardly hit, and is, therefore, less keenly impelled towards harder work and greater personal economies, and partly that loan scrip is excellent collateral on which banks will be ready to lend him money. This consideration tends *pro tanto* against the policy of finance by loans.

11. A third relevant consideration is the comparative effect of finance by taxation and finance by loans upon distribution. As between people of equal wealth in different situations, there is a strong practical argument in favour of voluntary loans as against taxes. Under voluntary loans those persons tend to subscribe who can do so with least difficulty. Of two men, for example, of equal wealth, one of whom is halfway through the building of a factory when a loan is raised, while the other has no special call on his income, the second will naturally take up a much larger share of the loan. Under the tax method both these men would be forced to make the same contribution, and, though the factory builder would probably be able to arrange things somehow by borrowing himself, yet, unless he happened to have a considerable amount of suitable collateral, he might find it very difficult, expensive and inconvenient to do this. Under the loan method, those who have free money contribute it naturally and simply; under the tax

method it may have to be got from them through an elaborate roundabout process of loans made by them to people subject to the levy but lacking free money of their own. When money is suddenly needed to finance a war, the relatively small disturbance and agitation, which voluntary loans are likely, for this reason, to cause, is a clear point in their favour.

12. After all, however, the main problem of distribution in a State levy is, not to organise it conveniently as between people of equal wealth who happen to be differently situated at the moment, but to organise it fairly as between people of different grades of wealth. The fundamental point is this. The amount of resources which it is possible for a government by any plan to draw in a short time from the poor is strictly limited. The available margin among them is, both for individuals and for the poor as a group, small. Consequently, when a large sum has to be raised in, say, a single year, it is *necessary* that by far the greater part of it shall be raised somehow from better-to-do people. Furthermore, it is plain that, generally speaking, as we pass up the scale of wealth, every increase in an individual's income means, not merely an increase in the available margin of resources, but an increase which grows more than in proportion to the growth of income. If one man is twice as rich as another, other things being equal, his available margin is not twice as large, but more than twice as large. Hence, of the money needed by the State the rich man *must* provide, in one way or another, more than the poor man, and the very

rich man more than the moderately rich man ; and the amount provided *must* increase, not merely proportionately, but progressively as wealth increases. Now, if the practical choice was between the provision of money in these proportions by taxes and by loans—the distinction between compulsory and voluntary loans is here irrelevant—the *revenue to pay interest on which would afterwards be assessed on the different classes in these same proportions*, there would be no difference between the distributional effects of the two plans. But, if the above italicised condition is not appended to the loan plan, there is a very important difference. In fact, that condition is very unlikely to be fulfilled. Taxes afterwards are likely to be assessed on poor people in substantially larger proportion than their contribution to war loans. Hence, whereas the tax method throws on rich people at the time a larger share of the war burden than they are accustomed to bear of ordinary national charges and does nothing else, the loan method, while operating similarly at the time, arranges, in effect, that these rich people or their successors shall afterwards be partially compensated for their large immediate burden by moneys extracted in their interest from poor people. Looking at the matter broadly and taking a fairly long view, we may say that under the tax method rich people will bear a much higher proportion of the war charges than they do of normal peace charges ; under the loan method they will bear a proportion somewhat, but probably not much, larger than that.

13. The bearing of this conclusion on the practical comparison between finance by taxation and finance by loans depends on our opinion about what is the right relative distribution of war burdens and normal peace burdens. Two considerations are relevant here. First, when, as in normal times, what is wanted is a regular annual revenue, it is natural to base taxation in a general way upon income. But, as will be argued in detail in Chapter XVII., when a single and entirely abnormal expenditure has to be met, ability to pay is best reflected, not in the income that happens to accrue in that particular year, but rather in income-getting power, or capital—this term being taken to include objects of wealth not used in trade, such as houses and pictures, and also the capitalised value of a man's mental and manual powers.¹ Since £100 of 'earned income,' being terminable with life, represents much less 'capital' than £100 of income derived from the funds, and since funded and other property

¹ It is not, of course, suggested that the costs of a war can be paid for *out of* capital, in the sense that a person's holdings of land or factories or railways (except so far as they are saleable abroad in return for 'income') can actually be used for war purposes. The *source* of the funds raised must be the real income of the country. None the less, it would be possible for the government to collect a large part of what is required for war from persons who have no income at all but only property. If £1000 were taken from such a person, he would have, in effect, to buy with £1000 worth of property £1000 worth of real income from somebody else and to hand this over to the Government. He would be the *subject* of the tax, though his property would not be the *source* of it. (Cf. *ante*, Ch. IV.)

is held predominantly by the rich, this consideration suggests that war charges ought to be thrown upon the rich in a greater proportion than the principles appropriate to peace taxation would warrant. Secondly, there is a general feeling that, in a pre-eminent national emergency, the call from each should be for his *utmost* rather than for his *share*. Men are required to give of their physical strength, not in equal proportions, but from each his all. There is no question of proportionate sacrifice between men of fuller and emptier lives. Indeed, the strong are taken and the weak rejected. It is difficult to see what ground of equity there can be for any different distribution in the summons to financial strength. But this is certainly not the distribution aimed at in the ordinary tax system; and, therefore, some departure from the principles that underlie that system seems to be called for.

14. It is plain that the general trend of the various considerations set out so far points towards the financing of war by taxation rather than by (domestic) loans. There remains, however, a final consideration of a different colour, which must give us pause. If all wars were very short, and the funds needed for them could be raised at one single blow, what has been said above would be applicable without qualification. But, in fact, wars may last for a number of years. When this happens, or there is fear of this happening, the tax plan acts, not merely through the fact of it at the moment, but also through the expectation of its continuance during the war. Just in so far, therefore, as it is

thought by the people subjected to it to hit them more severely than loan methods would do, the knowledge that a large part of the fruit of any exertions they make will be absorbed by the State may, in spite of the patriotic stimulus that wars provide, seriously lessen their current exertions. Had that part of the expenses of the Great War which was defrayed out of domestic loans—even apart from creations of bank credits—been defrayed instead out of taxation, not only would the standard rate of income-tax have had to be enormously higher than the 6s. level which it actually attained, but a great mass of other taxation on the top of income-tax and excess profits duty must also have been imposed. Such a state of things continuing for a number of years might have led to a serious depletion of that real income of services and goods from which alone the real war fund can be drawn. This, to a statesman caring above all things to ensure victory, or, at the worst, avert defeat, is a consideration of supreme importance. It explains and, in the opinion of some persons not unqualified to judge, excuses what many economists deemed the undue hesitation even of the British Government in the use of taxation to finance the Great War.

CHAPTER IX

THE TECHNIQUE OF VOLUNTARY LOANS

1. IN the Great War it was very important for the British Government to make its voluntary loans as productive as possible : for, failing an abundant response, it would have needed either to cut down its military expenditure, thus endangering the war position, or to have fallen back on the risky experiment of compulsion, or to have relied more largely on credit creations, with their injurious reactions upon prices and distribution. Consequently, resort was had to a number of indirect measures designed to swell the flow of loan money to the Treasury. Some of these measures were positive, others negative.

2. The most obvious positive measure is the offer of high interest. For the sake of future budgets every government will be disinclined to put the rate very high. To some extent their unwillingness to do this is unjustified. For, in so far as the alternative to high interest on war loan is the creation of more bank credits, this creation means raised prices, which, in turn, mean a larger

capital debt on given government purchases ; and future budgets may be just as much burdened by a larger debt at lower interest as by a smaller debt at higher interest. Against high interest rates there is, however, a serious political objection. One country dares not offer loans at a much higher rate than its opponents in war, for, if it does, public opinion in neutral countries may suspect its financial strength, and neutral governments are more likely to take sides against it. From this point of view it is sometimes found desirable to 'camouflage' the real terms on which a loan is offered, so that only persons concerned with business will understand them. Thus, advantages may be given, not in the nominal rate, but in issue below par value, in premiums on repayment or in special privileges in the matter of taxation.

3. It is also possible to increase the attractiveness of loans, without any improvement in the actual terms offered, by so adapting their method and form as to appeal to a wide range of tastes. Thus, in the Great War there were offered savings certificates to be repaid in a lump sum with accumulated interest after an interval of several years, long-dated war loans, short-dated Exchequer bonds and six or twelve months' Treasury bills for the money market. Spectacular loans to be subscribed for between definite dates alternated with 'continuous borrowing' by means of Exchequer bonds always 'on tap.' Great efforts, in short, were made to render the government's securities suitable for all classes of investors.

4. To these methods there is added in war-time the special appeal to patriotism. This may take the form of propagandist advertisement through newspapers, public meetings, tank weeks, the stimulation of competitive endeavours among different towns to break one another's record of subscriptions, and so on. Appeals to patriotism are not, however, by themselves apt, in the monetary sphere, to prove very productive. It is difficult to tell, for example, how far 'tank weeks' really yield money, or how far they merely cause money to be subscribed in a particular way or at a particular moment, which would in any case have come in to the Treasury somehow.

5. Negative methods of stimulating the flow of war loan consist in cutting off from private people alternative methods of employing their money. The available alternative methods are (1) buying new output of capital goods, such as plant or machinery or raw material; (2) buying new output of consumable goods and services, such as food or travel; (3) handing over money and the right to dispose of it to other people in exchange for existing properties or for promises of future interest payments. Since the persons to whom money is handed over in this last way can in turn, if they do not put it into war loan, only buy with it either new output of capital goods or new output of consumable goods, these two sorts of purchase are ultimately the only alternative employments for money besides war loan. *Direct* negative methods of stimulating the flow of war loan consist, therefore,

in blocking up, in greater or less degree, these channels.

6. At first sight it is natural to suppose that, if people are compelled to reduce their expenditure on any single sort of article, the fund available for war loan subscriptions is necessarily increased to *some* extent. This, however, is not so. Though it must follow that more of the particular article, on which expenditure is retrenched, will be set free for government, it need not follow that a larger aggregate sum of money will be set free. If the purpose which a prohibited or restricted article serves is very urgent, and if it can also be served more or less by some other article that is not obstructed, prohibition or restriction will press purchasing power towards this rival article. If people do not much care about satisfying the purpose, and if the rival article is more expensive and inconvenient, no great volume of productive resources will be directed to it, and the resources secured by withdrawal from the prohibited or restricted article will be almost entirely a net saving. But, if people care a great deal about the purpose which the State is obstructing, they may insist on satisfying it somehow at whatever trouble and cost ; and it may then happen that the roundabout method, to which they are compelled to resort, actually absorbs more productive power and costs more money than used to be needed before. A good illustration is afforded by the imposition of duties upon certain classes of imports unaccompanied by excise duties on analogous products (*e.g.* rival types

of motor car) made at home. Instead of causing people to employ less capital and labour, represented by less money, for the need they used to satisfy by importation, the imposition of these duties *may* cause them to satisfy their need through increased manufacture of analogous home products at a greater aggregate cost in capital and labour, represented by a greater sum of money, than used to be required to make exportable goods with which to buy the imports. It is not true, of course, that the prohibition or restriction of selected articles is *bound* to fail in checking the aggregate volume of resources, and their representative money, that is devoted to private service. But it is true that it is much more likely to fail than people and governments generally understand, and that, if it is to succeed, great care must be exercised in the choice and grouping of the things selected for State discouragement.

7. This, however, is not all. There is a large number of different types both of capital goods and of consumption goods. If, therefore, the routes leading to only a few of these are blocked up, however skilfully these few are selected, only a small part of the money which the blocking extrudes from them is likely to become available for war loan: the main part will be scattered among other employments that are not restricted. From this it follows that, in ordinary peace conditions, there is little use in restricting other openings as a means of stimulating the flow of resources to a particular opening; for in these conditions it

would be feasible to restrict only a very few openings. In war, however, restriction can be applied so widely that a single non-restricted opening, namely war loan, may expect to reap a great part of the fruits of it. Thus, in the Great War private expenditure on capital goods was blocked up by a strict limitation, through priority certificates, of the purchase by private persons of a number of important structural materials: and private expenditure on consumable goods was similarly blocked by rules about rationing and by restrictions, made necessary by the shortage of tonnage, on the importation of many luxury and semi-luxury articles.

8. So far attention has been confined to *direct* negative methods of stimulating the flow of war loan. There are also available indirect negative methods. As was indicated in section 5, it is open to a man with money, not merely to use it himself, but also, alternatively, to hand it over to somebody else to use. In modern communities a substantial part of their annual money income is handed over by the recipients, either immediately or at one or more removes, to persons intending to buy new output of capital goods with which to develop industrial concerns in this country, or to persons desiring to export goods abroad for capital investment there. If the handing over of money to these persons is obstructed, the original holders of the money, though they may be led to spend some of what they would have handed over in extra personal consumption and some in buying capital goods for their own private businesses,—such of them as have

private businesses—yet are unlikely to find a ready use for much of it in these ways, and may, therefore, be expected to turn a good deal of it into war loan. In the Great War the British Government took advantage of this fact. Investment of capital abroad was cut off altogether by Treasury Order, and investment in the outlying portions of the Empire was severely restricted. People were also forbidden to raise capital for investment in the United Kingdom without a licence from the Treasury, and that licence was only granted if the investment was such that a good case could be made out for permitting it.

CHAPTER X

FINANCE BY BANK CREDITS

1. WE have now to consider the remaining important method of war finance, namely, finance by the creation of bank credits. This system of finance, supported by abnormal issues of fiduciary notes, was largely resorted to during the war in all the principal belligerent countries, including the United Kingdom. I propose in the present chapter to describe and discuss our national variant of this common method. In that way it will be easy to exhibit the general principles that are involved.

2. It is customary for critics of British war finance to make use in connection with it of the term 'inflation.' It is, however, exceedingly difficult to find any definition of this term that is at all satisfactory. One popular definition asserts that inflation is an increase in money more than proportionate to the accompanying increase in production.¹

¹ This definition is incidentally thought to imply that "inflation is inherent in the flotation of a loan for purposes other than the construction of material reproductive capital," the idea being that, when the loan is employed productively,

Since, however, this definition compels us to say that a bad harvest involves inflation, it is too far out of touch with the common understanding of words to be admissible. An alternative definition associates the term inflation with *that part of the rise of prices that is consequent upon governmental interference with money and banking*. Practically, however, it seems impossible to disentangle this part from the part that would have taken place, particularly in war, if the government had allowed monetary affairs to proceed along the usual lines. Furthermore, the notion of "governmental interference with money and banking" is not precise. Certain government acts, of course, clearly constitute such interference, but certain others—for example, the commandeering of foreign securities to support exchange and propaganda to persuade people not to present currency notes for encashment—are doubtful. Again, certain things, which cannot take place in England without very definite government interference, are permissible in other countries under the ordinary law. Thus, the fiduciary note issue of the Reichsbank might, under pre-war legislation, be increased beyond the normal maximum on condition that a tax was paid on the extra issues. In view of these considerations it would appear that the only

extra things are created to offset the extra money. Obviously, however, no more extra things are produced *at the time* when a factory is built than when a house is built, or even than when people are set to work to make fireworks or guns. More extra things are, no doubt, produced later on when the factory begins to operate, but this fact is not relevant.

really satisfactory way of defining inflation along these lines would be to make an arbitrary schedule of the various sorts of action, which, for the purposes of the definition, are to be regarded as governmental interference with money and banking, and the fruits of which, therefore, are to be called inflation. But, when we are driven to an artificial plan of this kind, there is much to be said for abandoning the term altogether, and in the following pages I shall only use it under the protest of inverted commas.

3. During the Great War, and particularly during the earlier stages of it, the government, whether rightly or wrongly, were unwilling to push overt taxation beyond moderate limits, for fear of checking production and rousing powerful resentment. They were equally unwilling to put the rate of interest offered for war loan subscriptions above a moderate amount, lest our reputation for financial power should be damaged in the eyes of the world. As a result of these two things, the amount of money obtained by overt taxes and public loans fell in most weeks considerably below the exigent demands of the army, navy, air force and munitions establishments. Given these conditions and given the determination to cut our cloth according to our coat and not *vice versa*, the only course open to the government, apart from direct resort to the printing press, was to fill the gap between income and expenditure by causing the banks, and particularly the Bank of England, to create credits in its favour. Several methods of doing this were available.

4. The most important of these was that

described in the *First Interim Report of the Committee on Currency and Foreign Exchanges*, 1918, in the following terms: "Suppose, for example, that in a given week the Government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an advance from the Bank of England, which, by a book entry, places the amount required to the credit of Public Deposits, in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to contractors and other Government creditors, and passes, when the cheques are cleared, to the credit of their bankers in the books of the Bank of England; in other words, is transferred from Public to 'Other' deposits; the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the joint stock banks, and the bankers' cash at the Bank of England by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000, and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20 per cent) is improved."¹ The banks are then in a position to do any one of three things without making the proportion between their reserves and their liabilities any smaller than 20 per cent. Having got 10 millions more reserve and also 10 millions more

¹ *Interim Report of the Committee on Currency and Foreign Exchanges*, p. 2.

deposits, they may either (1) credit their customers with a further 40 millions of deposits, which these customers, we may suppose, devote to taking up Treasury bills or war loan; or (2) themselves take up out of their balances with the Bank of England 8 millions of Treasury bills or war loan; or (3) lend the spare 8 millions of their balances to the Bank of England, to be lent by it in turn to the government.

If the first of these methods is adopted the immediate result is as follows. The 40 millions extra deposits are transferred to the government's account at the Bank of England, thus, for the moment, reducing bankers' balances there by that amount. At the same time these 40 millions cease to count in bankers' deposit liabilities to customers. But the government forthwith expends the credit it has thus obtained, so that the 40 millions are again added both to bankers' balances at the Bank of England and to bankers' deposit liabilities. The final position then is as follows: bankers' balances at the Bank of England are 10 millions more than they were before the original 10 millions of credit were created, and bankers' deposit liabilities to customers 50 millions more, while the government has spent and owes 10 millions directly to the Bank of England and 40 millions indirectly to the banks through their customers.

If the second method is adopted, the immediate result is that the banks have 2 millions more balances at the Bank of England than they had before; 10 millions more deposits and 8 millions more Treasury bills or war loan. The government,

however, forthwith spends the 8 millions of balances that have been transferred to it, and these, therefore, appear again as an 8 millions addition both to bankers' balances at the Bank of England and to bankers' deposit liabilities to customers. We thus have a second stage, with bankers' balances at the Bank of England again 10 millions up and bankers' deposits now 18 millions up. The bankers have thus still a too favourable proportion; they only need one-fifth of 18 millions out of their 10 millions Bank of England balances, and are, therefore, in a position to take up a further $6\frac{2}{5}$ millions Treasury bills or war loans. When the government spends the balances with which the banks do this, we have a third step: bankers' balances at the Bank of England 10 millions up; bankers' deposit liabilities $24\frac{2}{5}$ millions up. It is obvious that this process will continue until eventually the bankers have taken up 40 millions of Treasury bills or war loan, and are left with deposits of 50 millions against balances at the Bank of England of 10 millions. Thus, this method leads in the end to the same result as the other method, save only that the government debt of 40 millions on Treasury bills or war loan is a direct debt to the banks instead of an indirect debt to them mediated by their customers.

On the third method distinguished above the banks lend their 8 millions of spare balances to the Bank of England to be lent by it to the government. On this plan the 8 millions come back, when the government spends them, both into bankers' balances at the Bank of England and into bankers' deposits;

and the same process as on the second method is carried through, with the final result that bankers' balances are 10 millions up and bankers' deposits 50 millions up. The government's debt of 40 millions (in addition to its original 10 millions debt to the Bank of England) is still a debt to the bankers, but this time mediated, not through their customers, but through the Bank of England. Thus, all three methods come in the end to exactly the same thing.¹ There is an original creation of 10 millions credit from the Bank of England to the government, and a subsequent creation of 40 millions from the other banks, which, in one or another way, is made available to the government, the two creations together involving an addition of 50 millions to the deposit liabilities of banks other than the Bank of England, based on an addition of 10 millions to their holdings of "cash in hand and at the Bank of England."

5. Credit creation may be initiated otherwise than by a draft of 10 millions on Ways and Means from the Bank of England. The government may

¹ It has been suggested that, at one period during the war, some of the banks counted the debt due to them from the Bank of England on account of their loaned balances as "cash in hand and at the Bank of England," and not as money at call or short notice, and so included it in the reserve on which their proportion is based. Obviously, if they did this, they would be in a position to lend a literally infinite amount to the Bank of England for reloan to the government without reducing this proportion below 20 per cent; for each million of balances thus transferred would, after it had been spent by the government, appear as a net addition of a million to deposits and also to reserve. There is no means of knowing how far, if at all, this policy was in fact adopted.

directly ask for subscriptions to Treasury bills or war loan from the banks (other than the Bank of England). The banks draw on their balances at the Bank of England to the extent of, say, 10 millions, and buy Treasury bills or war loan. These balances are restored to their former level so soon as the government spends the 10 millions, but the deposits are increased by 10 millions. Consequently, the proportion of banks' reserves to liabilities is diminished. To restore this proportion, they may call in their loans to customers to an extent equal to their 10 millions subscription to Treasury bills or war loan.

If the customers simply do without the loans thus drawn in, the banks' deposits are brought back to the figure at which they stood originally, while the bankers' balances with the Bank of England are also at their original figure. But, if, as will almost certainly happen in fact, the customers go to the Bank of England and it finds money for them, they will draw cheques on the Bank of England and so increase, to the extent of their loan from the Bank of England, at once the deposits and the balances at the Bank of England of their own banks. If this loan is 10 millions, it involves a 10 millions increase in bankers' balances at the Bank of England, and it, therefore, enables the banks to lend a further 40 millions to the government in Treasury bills in addition to the original subscription of 10 millions. It works, in fact, *exactly* in the same way as it would have done had the 10 millions Bank of England credit been created for the government instead of for private customers of the banks.

6. Yet a third alternative is open. The bankers, being asked to subscribe 40 millions to Treasury bills or war loan, are able to do this without either cutting down their loans to customers or weakening their proportion, if they can add 1 million to their reserve against each extra 5 millions of deposit liabilities. To make this possible, the government may sell to the bankers 10 millions of currency notes, to be held by them in their tills, in exchange for 10 millions of their balances at the Bank of England. The balances thus obtained by the government come back to the credit of the bankers when the government spends its money. The net result is an increase of 50 millions in their deposits and of 10 millions in their cash in hand and at the Bank of England; the government having raised 40 millions on Treasury bills and 10 millions in balances at the Bank of England, against a sale of 10 million notes to be held in bank reserves. Once again, therefore, we reach substantially the same position as before. For, from the point of view of the bankers, balances at the Bank of England and currency notes for banking reserves are on exactly the same footing. Both may be regarded indifferently as a step towards, or as a condition of, an aggregate credit creation of five times their own amount. If the government wishes for 50 millions of bank credits, it is a matter of indifference whether it provides the basis for this by getting a Ways and Means advance of 10 millions from the Bank of England or by selling 10 million notes (to be held as reserve) to the banks.

7. The creation of additional purchasing power in the form of bank balances, whether it is brought about by one of the processes described above or, as happens more ordinarily, by an expansion in the proportion of liabilities that banks (other than the Bank of England) venture to hold against their reserves, tends to promote a more or less corresponding rise of prices. Normally, under an effective gold standard such as existed before the war, this rise of prices, by encouraging imports and discouraging exports, turns the exchanges against us and threatens a foreign drain of gold. At the same time it makes it necessary for people to carry rather more money than before in their pockets and in their tills for the payment of expanded wage bills and for the conduct of retail business on the higher price level. In this way it sets up a domestic drain. These two drains together, by lessening the reserve of the Bank of England, compel the Bank to raise its discount rate and to take steps, by selling government stock or otherwise, to make the new rate effective in the market. The higher rate tends to check borrowing. If it does not actually do this at first, it will have to be raised still higher until it does do it; for, otherwise, the Bank would see its reserve completely exhausted. The financing of any customer, the government or anybody else, by the creation of bank credits is thus, in normal times, held closely in check. In the Great War the position was entirely abnormal. The government had to finance itself whatever rate of interest it had to pay. High discounts, therefore, would not have

stopped the credit machine from expanding. Whether they had been applied or not, the government must have insisted on its loans, and the gold reserve of the Bank of England would have continued to fall, had no safety-valve been opened, until the machine was smashed. It is true, indeed, that the external drain normally consequent upon credit creation could not manifest itself. For the export of gold by private persons was sufficiently provided against by the submarine peril and the refusal of the government to insure gold cargoes. But, unless a further basis of cash had been provided by direct State action, collapse must have come about through the internal drain. As the Committee on Currency and the Foreign Exchanges observe: "The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power, and, therefore, leading, in conjunction with other causes, to a great rise of prices, brought about a corresponding demand for legal tender currency, which could not have been satisfied under the stringent provisions of the Act of 1844. Contractors were obliged to draw cheques against their accounts in order to discharge their wage-bill—itself enhanced on account of the rise of prices."¹ No doubt, had gold been flowing into the country as the result of an abnormally favourable trade balance, as it was in fact flowing into the United States during certain of the war years, the required basis of legal tender money would, up to a point, have been provided without

¹ *Loc. cit.* p. 5.

any special State action. In these conditions bank credits could have been created in behalf either of the State or of private persons, and prices forced up, without any risk to the banking and monetary system. The foundation of the pyramid would have been enlarged, as it were, by automatic process. But in European countries, except at the very beginning of the war, the tendency was towards an outflow, rather than towards an inflow, of gold. Hence, the required basis of legal tender had to be provided by other means. To this end in the United Kingdom currency notes, designed in the early days of the war for the quite different purpose of parrying a possible hoarding drain on the part of the public, were issued by the Treasury in continually increasing quantities. It has already been explained how the sale of currency notes against bankers' balances, to be held by the banks as reserves, would operate. We are now concerned with the sale of notes required by bankers to meet the cash demands of their customers. The effect of this sale of notes against balances *plus* the resale of the notes by bankers to customers against deposits was ultimately, after the government had spent the balances obtained in exchange for the notes, to leave both the bankers' balances at the Bank of England and bankers' deposits the same as before. The government obtained new purchasing power equal to the value of the notes sold, but these notes, entering as they did into circulation among the public, did not constitute a basis for further credit creations in the way that notes sold to banks and

held by them as reserve did. In substance, therefore, the sale of notes against balances for passage into public circulation, while incidentally adding something to the purchasing power of government, was, in the main, a device for preventing the pyramid of credit from being broken up under the pressure of an internal drain. Their issue enabled the banks to meet the cash requirements of their customers, consequent on the high prices for which the pyramid of credit was responsible, without causing a drain upon the banking reserve of the Bank of England. "Given the necessity for the creation of bank credits in favour of the Government for the purpose of financing war expenditure, these issues could not be avoided. If they had not been made, the banks would have been unable to obtain legal tender with which to meet cheques drawn for cash on their customers' account. The unlimited issue of currency notes in exchange for credits (belonging to other bankers) at the Bank of England is at once a consequence and an essential condition of the methods which the Government found it necessary to adopt in order to meet their war expenditure."¹

8. It is a matter of some interest to determine how far, if at all, the very complicated method of obtaining resources for the government that I have been describing has different effects from those that would have been produced by a straightforward issue of currency notes in direct payment for the government's purchases. Apologists of

¹ *First Interim Report of the Committee on Currency and the Foreign Exchanges*, p. 5.

British war finance have made a great point of the fact that the printing press was not used in this way and that notes were only issued in response to business demands. At first sight it seems that this complacency is justified. For, on the plan actually adopted, the government's credits have been obtained in the form of bank balances, and notes have only been issued to support these balances : whereas, if government had simply created notes to pay for its purchases, these notes would have formed a basis for a very much larger creation of bank credit. This distinction, however, rests upon the assumption that, if the government had issued notes in direct payment of its purchases, all the notes so issued would have remained, as it were, "alive." This assumption is not justified. If the government in any week had created and paid to contractors 10 million one-pound notes, the contractors presumably would have deposited these notes with their bankers, only keeping in their own hands for wage payments the same number as, on the plan actually adopted, they drew out of their account for this purpose. The joint-stock banks in turn would have deposited these notes with the Bank of England, thus creating balances to their credit there equal to the balances that, on the other plan, they would have created by book transfers, and, equally with them, available for the purchase of Treasury bills. So soon, however, as currency notes enter the Bank of England, they are automatically cancelled and die. To make our comparison a fair one, we must suppose that this same

rule would hold good under the printing press plan. But, if it holds good, that plan, though it would involve the *creation* of many more notes than the actual plan, would only involve the *survival* of an approximately equal number. The only difference would be that the balances of bankers at the Bank of England, instead of being created by simple book transfers, would be brought into being through the agency of extra notes marked for destruction, which, in their brief span of life, accomplished nothing except to bring those balances into being. The printing press method, combined with the proviso that in the atmosphere of the Bank of England no currency note can live, is thus, contrary to common opinion, identical in its operation and consequences with the more roundabout policy that was in fact pursued by the British Treasury.

9. Let us now, having studied the mechanism, consider the essential character of these methods of war finance. Plainly, the creation of bank credits, whether for the government directly or for private people who have taxes and loan subscriptions to make to the government, is a mediating, not an ultimate, operation. Its effect is to give the government more purchasing power, and thus to deplete the real value of the purchasing power left to private persons. In this way it enables the government to get possession of more things and services, and so constitutes, as against the public, a concealed form of taxation. This taxation, moreover, is not graduated in any degree and not adjusted in any degree to the size of a man's family. It is simply

proportional to income without even an allowance to very poor people of a tax-free minimum of subsistence. This kind of taxation is generally acknowledged to be exceedingly unfair and oppressive to the poor. But that is not all. Besides drawing too much of what the government needs from the poor as compared with the rich, finance by bank credits also causes a large transfer of real income from one set of people (mainly the receivers of fixed incomes) to another set of people. This incidental disturbance is similar to the disturbance brought about by protective duties on agricultural produce, which, besides causing the consumers of imported produce to make a payment to the Treasury, also causes the consumers of home produce to make a payment to private persons—ultimately to the owners of agricultural land—at home. Some part of the shifting of distribution can, no doubt, be corrected by adjustment in the rates of payment made for various services. Thus, wage-earners can insist eventually on a rise of money wages more or less conformable to the rise of prices. But everywhere the process of adjustment is bound to involve much friction and some loss of production through industrial disputes; and, for some persons, *e.g.* debenture holders as against the holders of ordinary shares, no adjustment is possible at all. These considerations clearly show that, on the side of distribution, finance by the creation of bank credits is much inferior, not only to ordinary taxes, but even to ordinary loans.

10. It may perhaps be thought that, if, as has just

been claimed, finance by credit creation is, in effect, taxation, though of a peculiar kind, it should at least be credited with the superiority which that form of finance was shown in Chapter VIII. to possess over loans as regards immediate depletion of capital and ultimate discouragement of productive energy. It is true that finance by credit creation may well lead to a somewhat smaller drain than finance by loans would do on material capital. But, since it must strike especially hard~~y~~ upon the poor, it is certain to lead to a much greater drain upon that immaterial capital which is comprised in the strength and efficiency of the people. Little, if any, real advantage, therefore, can be looked for here. Much the same thing is true as regards the ultimate discouragement of productive energy. Finance by loans, as has been shown, indirectly involves such discouragement, because loans imply continuing taxes to provide interest and sinking fund later on: finance by taxation does not. The paradox of credit creation, at least on the British plan, is that, though, from the point of view of the public, it corresponds to finance by taxation, from the point of view of the government it is, in large part, finance by interest-bearing loans. So far, indeed, as balances for the government at the Bank of England are obtained in direct exchange for currency notes, no interest has to be paid. So far as they are obtained under Ways and Means advances from the Bank of England, interest is paid at a more or less arbitrary rate, which must not exceed 5 per cent. So far as the creation of credits at the Bank of

England and their transfer to the balances of other bankers enables these bankers, on the basis of their existing proportion, to increase their loans to government through the purchase of Treasury bills, interest at the current rate for these bills has to be paid. Thus we get three items : balances bought with notes on which there is no interest ; balances obtained by Ways and Means advances on which the interest is limited ; balances obtained by the sale of Treasury bills—a sale made possible by the creation of a legal tender basis for further bank credits—on which full interest has to be paid. The interest accumulating under the two latter heads accrues to the banking system of the country as a reward for its work in collecting, as it were, a forced levy on the public in behalf of the government. The payment of it necessitates taxation in the future just as the payment of interest on an ordinary loan does. *Pro tanto*, therefore, in accordance with the reasoning in Section 9 of Chapter VIII., it must make against industrial energy after the war is over.

✓ II. On the strength of these various considerations it is generally agreed that, though the creation of bank credits may be a convenient means of meeting war requirements at an early stage, before there has been time to organise an adequate scheme of taxation and public loans, yet, even apart from its aftermath of monetary and exchange complications, to which reference will be made in a later chapter, the method is inherently bad, and a government at war should restrict it within the narrowest

possible limits. As was indicated, however, in the third paragraph of this chapter, the fear of popular resentment against high taxation in an overt form and the fear that an offer of very high interest for loans might make upon neutrals an impression of financial weakness are likely to compel even strong governments to resort to it in some measure.

CHAPTER XI

PRICE CONTROL

1. IN this chapter I am not concerned with price control over monopolists, whether public utility concerns or others, but with control where the factor making for high prices is independent of monopoly. This kind of price control was unknown in modern times until the Great War. During the war it assumed great importance and covered a wide range. The purpose of it was to stop 'profiteering' on the part of certain fortunately situated individuals against the general community—more particularly in respect of things purchased from them by the government and of essential goods that played a large part in the consumption of the poorer classes. Broadly put, the position was as follows. The war caused in two ways a great shortage in certain things. On the one hand, for munition articles, army clothes and so forth, there was an enormous new government need much in excess of normal supplies. On the other hand, for various articles of ordinary civilian use, the contraction of available tonnage and the withdrawal of labour for

the army and munition work caused supplies to fall much below the normal. The shortage brought about in one or other of these ways put it in the power of persons who happened to hold stocks of short commodities, or to be able to produce them quickly, to charge for them prices very much higher than usual. When the shortage was due to increased government demand, the scale of business done by these persons being as large as, or larger than, before, the high prices that they were enabled to charge necessarily yielded them abnormally large profits. When it was due to contraction of supply (*e.g.* through the withdrawal of labour or other obstacles to output), the gain from high prices *might* be cancelled by loss due to lessened sales ; so that abnormally large profits were not obtained. For a great number of things, however, the conditions of demand are such that a shortage of, say, 10 per cent in the supply causes the price offered by purchasers to rise by much more than 10 per cent. For the sellers of articles of this class the shortage, even when it was due to a supply contraction, often meant abnormal profits. Of course, some of these abnormal profits were more apparent than real, for, if prices all round are doubled, a doubling of money profits will only enable a man to get the same amount of things as before. Very often, however, the money profits were enhanced very much more than in proportion to the rise in general prices. Wherever this happened, certain specially favoured persons were benefiting greatly as a direct consequence of the war. This state of things

naturally caused resentment, and suggested State interference.

2. It must be clearly understood that the thing war sentiment seeks to eliminate is not merely *high* profits. In America, at one period of the war, a profits tax was imposed based on the excess earnings of corporations above a defined percentage on their capital, whether or not earnings as high as this had been accruing to them before the war also. This kind of thing is not relevant to our present problem. That problem is to prevent fortunately situated persons from absorbing large *war* profits. We have nothing to do with the fact that, even in ordinary times, some individual producers in every industry, whether from superior ability or from luck or from the ownership of a site situated specially near to good markets or railway facilities, obtain a much bigger profit than others. Our objective is, not differences between the earnings of some producers and of others of the same class in normal times, but differences between the earnings of the general body of people producing a particular thing on account of the war and apart from it. It may be said at once that the problem of isolating these differences cannot be completely solved, because, within special profits accruing during the war, it is not possible in a general way—though a rough allowance can be made for the circumstances of new firms—to distinguish between those special profits that are, and those that are not, *due* to the war. With a few reservations it is necessary to assume that they are all due to the war, although we know that the assumption is not in fact

correct. This is unfortunate, but it cannot practically be avoided.

3. When the above assumption is made, it may seem at first sight that what public sentiment will seek to prevent or restrict are war-time money profits exceeding (by more than a 'fair return' on any new capital that may have been invested) pre-war money profits. Unfortunately, however, as has already been indicated, with general prices soaring upwards, a given money profit means a diminished real profit. It is proper that allowance should be made for this. A natural suggestion is that this could be done quite simply by multiplying the rate of money profit previously earned by the proportionate rise in general prices. So far as profit consists of interest on capital previously invested, this is correct. It is correct, too, so far as profit consists of payment for the services of management and so forth. But for new capital invested during the period when high prices were ruling the change in prices has no relevance. This change has already been reckoned in the face value of the capital. On the other hand, if the general rate of money interest has risen, that change should, of course, be taken into account in formulating our standard of reasonable return. In practice, these complications cannot be allowed for on any exact plan. Plainly, however, they *ought* to be allowed for so far as the information accessible to government permits. So far as they are not allowed for, any method aimed at eliminating or restricting war profits is imperfect.

4. Among these methods the most obvious are

the method of excess (war) profits taxation and the method of maximum prices. Under the former method, if it were employed by itself, fortunately situated sellers would be left free to charge such prices as the market would bear, thus collecting abnormal profits in the first instance; but would afterwards be deprived of the bulk of them, for the benefit of the Exchequer, by a high war profits tax. Under the latter method the prices that sellers are allowed to charge would be limited by authority to rates at which it is estimated that abnormal profits will not accrue to them. The excess (war) profits method, enormously fruitful though it proved during the war, is open to grave objection. It deprives producers of the normal motive for striving after economical methods of production and tempts them into all sorts of evasive wastes. Moreover, since an experiment that succeeds is not permitted to yield them a good return, while one that fails must expose them to loss, the spirit of enterprise will be checked. There is, however, a more decisive objection to allowing the excess (war) profits method to operate alone. Broadly and generally we may say that the choice between it and the maximum price method makes no difference to fortunately situated sellers. But it makes a great difference to the people who happen to need the particular goods or services that these persons sell. For, whereas under the maximum price plan they are left untouched, under the excess (war) profits plan a special levy is, in effect, placed upon them for the benefit of the general body of taxpayers. Where, therefore, the taxpayers them-

selves, through the government, are the principal buyers, or where the public are buyers more or less in the proportion in which they are taxpayers, it does not greatly matter which of the two plans is chosen. But, where, as in practically all articles of food, poor people play a much larger part, compared with rich people, as buyers of an article which is short than they play as taxpayers, it does greatly matter. For, if the State were to adopt the excess profits plan in preference to the maximum prices plan, it would be relieving the well-to-do of a large block of taxation, and throwing it, by a roundabout and semi-secret process, upon the shoulders of the poor. Whatever might be thought of the desirability of exacting a larger contribution from relatively poor persons, a device of that kind would never be tolerated. Consequently, in the Great War, over a large part of the field, the excess profits plan could not practically be made the *main* engine for preventing fortunately situated sellers from making fortunes out of the war. Resort had of necessity to be had also to the plan of maximum prices.

5. It may conceivably be objected *in limine* that the whole idea of price limitation as a means of helping the public against possible exploiters is illusory, because an enforced cheapening of one sort of goods will merely lead indirectly to an increase in the prices of other sorts. If, it may be argued, the government forces coal-owners or farmers to charge less for their product than market conditions would allow, people—who, in the conditions of shortage, may be presumed to buy the same quantity of coal or bread

whether price is controlled or not—will have more purchasing power left to them with which to buy other things. Consequently, the prices of other things will go up correspondingly and nobody will be really any better off than before. This argument is not, however, correct ; for it tacitly assumes that coal-owners and farmers will buy the same quantity of things for themselves, whether or not they are allowed to make special profits out of the general public. This, of course, they will not be able to do. To forbid them to make profiteering charges means, in short, that the share of the real income of the community under their command is diminished and the share under other people's command increased. No doubt, as a consequence of this distributional change, the relative prices of various sorts of goods will be modified ; but it is impossible that they should be modified so far as to wipe out the advantage which the changed distribution of purchasing power confers on the general public other than coal-owners and agriculturists at the expense of those persons. This is true whether or not any indirect effects are produced on the general monetary position. In fact, in the peculiar circumstances of the Great War freedom to sellers to exact enormous prices for things sold to the government itself forced the government to raise more funds by credit creation than would have been needed otherwise ; and restriction of this freedom led indirectly to a lessening of credit creation. This state of things implies a check to the upward movement of prices all round.

6. Government restriction of particular prices is not then a proceeding necessarily foredoomed to fail of its purpose, and it becomes important to consider the problem of working it out in detail. In the attempts made to solve this problem in the United Kingdom during the course of the war a great number of difficulties emerged, which it will be well to set out in order. The first of these was the difficulty of definition. The same name often covers a great variety of different qualities of article, which it may be extremely hard to disentangle in any formal schedule. When this condition prevails it is impossible to exercise control over prices by general rules, and it becomes necessary to fall back upon the cumbrous device of individual appraisal. Thus, under the Raw Cocoa Order of March, 1918, it was laid down that no raw cocoa might be sold except at 'a fair value,' this fair value being determined by a person authorised by the Food Controller to determine the grade of the various lots of cocoa. The same plan was adopted at the end of 1917 for controlling the prices of cattle and sheep sold by live weight at market. Obviously, however, this plan could not be employed on a large scale, owing to the vast amount of labour that it involves. Consequently, in general, some modification of it was essential, and some general classification of grades had, in spite of the openings for evasion that this permits, to be, in one way or another, relied upon.

A second difficulty, when the problem of *defining* grades of quality was overcome, resulted from the

mere fact that grades were often very numerous. The task of fixing prices directly for a great variety of these might well be more than any authority, at all events in the earlier stages of its operation, was prepared to enter upon. When there were only a few grades, it was comparatively easy, with the help of advice from experts, to do this ; but, when there were a great many, it was thought better to rely, not on a schedule of maximum prices, but on a general order determining the relations between the prices that might be charged in the future and those that had been charged in the past. An example of this plan was the Order of the Ministry of Munitions, issued in August, 1916, by which sellers of machine tools were forbidden, except with the sanction of the Minister, henceforward to charge prices higher than they were charging in July, 1915.

An analogous difficulty had to be faced when a commodity, about the grading of which, perhaps, there was no need to trouble, was produced under different conditions in a number of different localities, in such wise that a single maximum price would not treat different producers fairly. Here, too, inability to construct a schedule as varied as the circumstances required forced the controlling authority to fall back on the plan of fixing, not future prices themselves, but the relation between future prices and past prices. Thus, in May, 1917, an Order was issued that no imported soft wood should be sold at prices above those that ruled *in each several locality* in the week ending January 31, 1917. This Order was subsequently modified as regards im-

ports from Scandinavia ; but with that we are not concerned.

So far it has been tacitly assumed that the maximum price aimed at for any one commodity of a given grade is a single price. For some commodities, however, no one uniform price ruling throughout the year is adapted to the conditions of their production and sale, and a series of maxima is needed. Plainly, a series is more difficult to determine correctly than a single price. Consequently, here again the controlling authority was driven to the method of regulating the *relation* between future and past prices. Thus, in July, 1917, it was ordered that the wholesale price of milk per imperial gallon should not henceforward anywhere exceed by more than $6\frac{1}{2}$ d. the price charged in the corresponding month a year before, and that the retail price per imperial quart should not exceed this corresponding price by more than 2d. The same plan was followed in the Price of Coal (Limitation) Act of 1915, which decreed that no colliery company should charge a price exceeding by more than 4s. (afterwards raised to 6s. 6d.) the price charged on a similar sale at a similar date in 1913-14.

Plainly, all these indirect and roundabout methods of control left the way open for evasion and were likely to prove difficult to enforce. Consequently, controlling authorities, as they got a better grip and better knowledge of the conditions of various industries, tried to step forward to the more precise method of maximum price schedules. More and more this became the predominant plan. The

producers' and wholesalers' prices of most of the more important articles of food came to be fixed directly by schedule, as were also the prices of most of the commodities controlled by the Ministry of Munitions. For most things it was found sufficient to set up a single schedule. But sometimes different producers' prices were fixed for different parts of the country. With bulky and heavy articles, unless this was done, there would be a tendency for the things to stagnate near the places where they were produced. Hence, for hay, for example, Scotland was given one price, England another. Sometimes, too, a series of schedules was set up to apply to different parts of the year. Unless this was done people would be tempted to sell out all the supplies of things the production of which was seasonal directly after the harvest, instead of distributing sales and so consumption, fairly evenly over the year. For potatoes the Order of February, 1917, fixed one price up till March 31, and another higher price after that date; and for peas and beans an Order of May, 1917, fixed three prices, diminishing in amount for sales in June, July and later months. Similarly for wheat, oats and barley, to be harvested in the United Kingdom, the Food Controller, in August, 1917, fixed a series of prices rising gradually in each successive two months from November, 1917 on to June, 1918. A later Order fixing maximum milk prices made a similar differentiation between different parts of the year. It is plain that the direct establishment of maximum prices is, if the appropriate prices can once be worked out satisfactorily

likely to prove much more effective than any round-about plan.

So far we have only taken account of industries so simply organised that the producers sell a finished product direct, without any intermediary, to ultimate consumers. In most industries, however, there are several stages between the original material or service and the finished product in consumers' hands. This fact gives rise to further problems. The conditions of demand for any finished product being given, when a maximum price less than the demand price of the available quantity of any material or service used in making and selling it is fixed, the price of the finished product need not be lowered correspondingly, but it is in the power of any unregulated seller in a line between the provider of this material or service and the consumer of the finished product to add on to his charges the equivalent of whatever has been knocked off the charges of the regulated sellers. Thus, if the price of coal at the pit-mouth were reduced by State action and nothing else were done, the only effect might be that dealers in coal would buy more cheaply while retaining the old price of sale. Again, if the price of cattle were forced down and nothing else done, retail prices might remain unaltered, while butchers and meat dealers gained enormously. Yet again, if freight-rates on imported materials were kept artificially low by government action, the various people who use these materials in their industries might get the whole benefit. Nor is it merely *possible* that this *might* happen. In general it *would* happen, except

in so far as the people on whom a power of exaction was thus conferred, deliberately from patriotic motives, or from fear of popular resentment, decided to forgo their advantage.¹ In order to prevent this, the fixing of maximum prices at the earlier stages of production had to be coupled with control over the profits which manufacturers or dealers at a later stage might make by adding further charges on to these prices. One way in which this control was exercised was by limiting the *percentage* addition that might be made by any seller in the line. In May, 1917, for example, it was decreed that no timber from Russia should be sold at an advance of more than 10 per cent on the purchase price; and in September, 1917, a schedule of prices for fish was fixed as between fish-curers and wholesale dealers, and other sellers (with the exception of retailers) were prohibited from adding more than 10 per cent on to the scheduled prices. More usually it was not the *percentage*, but the *amount*, of addition that was limited. Thus, under the Cheese Order of August, 1917, first-hand prices of various sorts of British-made cheese were fixed as from the maker, and it was provided that no dealer other than the maker should add on to them more than the actual charge for transport *plus*, in general, 6s. per cwt. In October it was provided further that retailers

¹ This consideration may properly be urged by an individual producer if he is challenged out of patriotism to reduce his charges voluntarily below market level. He may rightly urge that for him to do this would merely put money into the pockets of dealers intermediate between him and the consuming public.

should not add on to the prices actually paid by them more than $2\frac{1}{2}$ d. per lb. In the same month the prices of the various sorts of leather were regulated on the same general plan. In like manner, the price of horse and poultry mixture was controlled, in November, 1917, by an Order forbidding the maker to charge a price exceeding the cost to him of his ingredients by more than £1 : 10s. per ton ; and the amount that other sellers might add on was limited to 1s. per cwt. on sales of 6 cwt. and more, 3s. per cwt. on sales of from 3 to 6 cwt., and so on. In meat a variant on this plan was adopted, in the first instance, on account of difficulties due to the custom among retailers of obtaining different proportions of their profit from the sale of different joints. In an Order of September, 1917, it was laid down that no person should in any fortnight sell meat by retail at prices that would cause the aggregate price received by him to exceed actual costs to him by more than a prescribed percentage (20 per cent or $2\frac{1}{2}$ d. per lb., whichever shall be less). In August, 1917, a rule on similar lines was laid down for retailers of bacon and hams.

It is evident that plans of this kind for controlling the charges to be made at the later stages of a commodity's progress to the consumer suffer from the same sort of disadvantage that roundabout attempts to control producers' charges suffer from. They are liable to evasion. Consequently, the controlling authorities sought, as they became more masters of their work, to evolve some more satisfactory arrangement. One stage in this evolution is illustrated by

the Butter Prices Order of August, 1917. In that Order it was laid down that retailers should not add to the price of butter sold by them more than $2\frac{1}{2}$ d. per lb. above the actual cost of it to them ; but it was provided further that local Food Control Committees *might* prescribe a scale of maximum retail prices in accordance with the general directions of the Order (which includes rules about maker's, importer's and wholesaler's prices), although conformity with that scale should not relieve any retailer from the obligation not to add on more than $2\frac{1}{2}$ d. per lb. A slightly more advanced stage is illustrated by the plan adopted for regulating the retail prices of coal. The general principle was laid down that retailers should not add on to their own purchase price more than 1s. per ton over and above the costs of actual handling and dealing with the coal (including office expenses apart from the trader's own salary). But this principle was not left, as it were, in the air. It was provided that local authorities, after consultation and inquiry, should work it out and apply it in the form of a definite list of retail prices applicable to their district. Yet a further stage is reached when the controlling authority itself fixes lists of maximum prices at more than one point on the way from producer to consumer. The Potatoes Order of September, 1917, was of this type. Maximum prices were fixed for growers ; wholesale dealers were forbidden to sell in any week at prices that yielded them more than 7s. 6d. a ton beyond their total costs on all purchases of potatoes—costs which varied with

the transport conditions of different districts—and an elaborate scale of retail prices was fixed, which related the permitted price per lb. to the price per cwt., including price of transport, that the retailer had actually paid for different classes of potatoes. The final stage is reached when definite schedules are fixed throughout—for producer, wholesaler and retailer equally—by the controlling authority itself. This was the arrangement to which the Ministry of Food steadily progressed. It was definitely attained in regard to British onions, most sorts of fish, beef and mutton, jam and fruit for jam, peas and beans, hay, oats and wheat straw. Lest, through imperfect knowledge, the special circumstances of particular districts should have been neglected in the construction of these scales, a safeguard was sometimes provided in the form of a rule empowering local Food Committees, with the sanction of the Food Controller, to vary the maxima in their district. This provision was introduced into the Order of January, 1918, fixing maximum prices for rabbits. In like manner, it was provided in an Order of September, 1917, that, where the Food Controller or a local Food Committee was satisfied that, by reason of some exceptional circumstance, flour or bread could not be sold by retail at the official maximum price “so as to yield a reasonable profit,” a licence might be issued, either for the whole or for a part of any Committee’s area, permitting higher prices to be charged. The Order of January, 1918, fixing a schedule of maximum prices for most kinds of fish, was made subject, as regards retail prices, to similar

local revision, as was also the Milk Prices Order of March, 1918. A like power of varying local retail prices, with the sanction of the Food Controller, was accorded to the local Food Committees under the Potato Prices Order of September, 1917.

Hitherto attention has been confined to commodities that come into the consumer's hands in much the same form as that in which they leave the hands of producers. Further complications are introduced when we have to do with raw materials that are worked up into elaborated finished articles. Here, owing to the varying parts which the raw material plays in different types and grades of finished goods, it is not generally possible to fix schedules of prices beyond the raw material. Consequently, for two important articles, boots and clothes, an ingenious roundabout plan was adopted. An attempt was made to induce, or compel, manufacturers to devote a considerable part of their plant to making 'standard articles' to be sold at prices calculated on a basis of conversion costs, in the hope that the competition of these articles in the market would indirectly keep down the price that it was profitable to charge for similar articles that were not standardised. In boots, manufacturers were ordered to devote one-third of that part of their plant which was engaged on civilian work to making 'standard boots.' In clothes, no fixed proportion of plant was forced into making standard suits, but manufacturers were tempted to take up this kind of work by relatively favourable treatment in the matter of the quota of raw wool allowed to them. In cotton

goods, though the price of raw cotton was artificially controlled, no corresponding control of the finished commodity was attempted, the argument being that cotton manufacturers were sufficiently burdened by having to provide a special levy to pay benefit to work-people thrown out of work by the reduction in the number of spindles and looms that they were allowed to operate.

7. Up to this point we have been concerned with matters of technique. We now come to a more fundamental issue. *Prima facie*, authoritative limitation of the price that may be charged for goods produced under competitive conditions is likely to check production. When something is being produced by a monopolist, who is charging for it more than the supply price of the quantity he is selling, such price limitation, by preventing him from seeking his gain by high prices, may force him to seek it through large sales, and so may actually stimulate production. But, for goods produced under competitive conditions, sellers could not in any event charge more than the supply price of the quantity sold, and, therefore, limitation of price, at the same time that it prevents the occurrence of abnormal profits, will cause output to be smaller than it would be if prices were left free. The reason, of course, is that, when there is a shortage of anything, it is just through the prospect of high prices and high profits that the shortage corrects itself. The prospect of exceptional gains diverts free resources into the industry which is making the things that are short. Cut off this prospect, and the associated increase of

supply will be checked. Any practical policy of price control must take account of this fact. There is no question, as has already been explained, of cutting any special profits that well-managed or fortunately-situated firms were making before the war, or of striking at the differential advantages they enjoy as against other firms. The war profit that it is sought to prevent or reduce is further profit due to the high prices associated with war, in which, in general, all firms would share. Nobody would suggest forcing down prices below the point at which this special war profit is done away. The true issue is how much higher than this they should be allowed to stand. A little war 'profiteering' is less harmful than a large check to output; a great deal of profiteering is more harmful than a very small check. A government, which has decided in a general way to control prices, has to decide further how far it will cut them below the level that free competition would bring about towards the level that would yield the pre-war scale of profit; and, in forming this decision, it has to balance the evils of various amounts of profiteering against those of various degrees of check to supply.

8. The effect of any given cut in prices below the 'natural' level, which unfettered competition would bring about, depends on how elastic is the supply of the controlled article. The supply of imported goods, such as wheat and silver, is extremely elastic to this country, because there are many other markets open to the sellers of them besides the United Kingdom. If the govern-

ment attempted to fix maximum prices for these things substantially below the ruling world price, the supplies available to this country would be very greatly reduced. Consequently, as a matter of practice, no attempt was made to limit the prices which foreign importers were allowed to charge for their goods ; the government, and any private person who was allowed to buy at all, paid the price which market conditions, or, in some circumstances, the control policy of foreign governments, determined. Home-produced articles with a large export market would also normally have an elastic supply to purchasers in this country, because it is possible to divert sales from domestic to foreign buyers. For such things, therefore, if free export is permitted, price control is impracticable. It is, however, possible, as was done with British coal, to limit the amount of exportation that is permitted, and so to do away with this source of elasticity. Moreover, in war time, even if no overt rule is made, export may be automatically limited by the dangers of the sea. Yet again, there are many commodities which have not normally a large export market, and for which, therefore, the elasticity of supply of British-made stuff to British consumers is substantially equivalent to the elasticity of British production.

9. For these commodities, as, indeed, for all commodities, it is further important to observe that the elasticity of supply, or production, is not a single fixed thing. It, and the consequent check to output which a given cut in permitted price may be expected to bring about, is different according to the

length of time for which the cut is imposed. A *permanent* policy of preventing groups of producers (other than monopolists) from charging prices that yield abnormal profits on occasions when the conditions of the market give them power to do so would certainly react seriously on production. People, in making choice of investments, take account of the ups and downs, and, so far as their judgement is correct, place their resources in such a way that, on the average and on the whole, the rate of yield works out about equally in different occupations. In these circumstances for the State regularly to cut down prices in any industry below the competitive level at times when, if there were no government interference, that industry might expect to enjoy exceptional profits must, in effect, penalise it as compared with more stable industries. For if, in a hilly district where the average level of peaks and valleys is the same as it is on a plateau, the tops of the peaks are removed, the average level there will be reduced below that of the plateau. Differential action checks the flow of resources that would otherwise seek investment in building up the permanent equipment of the threatened industry. If, for example, the State adopted a general policy of forbidding farmers to charge abnormally high prices when there are bad world harvests, this would check investment in agriculture; because people expect bad world harvests from time to time and look to high prices then to set against low prices in bumper years. With price regulation limited to a single exceptional occasion, the position is,

however, quite different. Thus, if there is an exceptional shortage in the catch of fish on a day when fish happen to be in great demand, a limitation of price cannot interfere with the supply already caught, and, if it is understood that the limitation is for once only, it will not interfere with fishing activity afterwards. If the foreign supply of iron ore is cut off for one year, and it is known that the shortage will last for one year only, no practicable price would have called out a large increase in domestic supplies over so short a period, and, therefore, limitation of price will not make *much* difference. Yet again, if the short commodity is a thing like houses, of which the annual output is necessarily small relatively to the total stock, to limit price for a short time, even if it affects *production* substantially, cannot affect *supply* much. In the Great War the sort of price limitation aimed at was evidently single, exceptional, and, it was hoped, for a short time only. Consequently, its injurious effect upon production might be expected, even apart from the stimulating effect of patriotic propaganda, to be small.

10. In a general way the British Government endeavoured to fix their price maxima at levels that would not seriously reduce production below what it would have been in a market not subject to price regulation. This meant allowing charges that yielded very substantial profits to producers—profits which were afterwards in part absorbed by the Treasury under the excess profits tax. The method of allowing a wide margin in the maximum price

fixed upon is not, however, the only method by which it is possible to prevent production being substantially checked by price control. An alternative plan is to couple a comparatively low maximum price with the grant of a bounty on that part of the output which is produced with greatest difficulty and which, at the maximum price, it would not pay people to produce. For example, a maximum price for wheat calculated to yield normal profits on some given estimated output might be established; and at the same time it might be provided that farmers should receive a bonus on any addition to the wheat crop above their previous output or, to get over the difficulty of harvest variations, on any addition to their acreage under wheat. In like manner, maximum rents might be fixed for work-people's houses, but on new houses built after some arranged date a subsidy might be paid. In industry proper this device would, no doubt, be exceedingly difficult to administer. It is, however, worthy of closer study than has yet been accorded to it. An essential point to keep in mind is that a bounty of the type here contemplated, designed to cancel the restrictive effect on production of governmental limitation of price, is fundamentally different from a bounty unaccompanied by any system of general price restriction. That type of bounty causes production of the bounty-fed article to be carried *further* than it would be under the working of competitive forces; the cancelling bounty aims at preventing price limitation from causing production to be carried less far than it would be under the free working of

these forces. This is a very important distinction. It is true that under both sorts of bounty the buyer of bounty-fed produce gets stuff, and pays for it, say, 10s., while the cost of production is, say, 15s. But, whereas, under the general bounty, if we ignore differences in wealth and taste among different people, the 10s. will measure the buyer's estimate of the benefit of the thing to him and the 15s. the seller's estimate of its cost of production to him, under the cancelling bounty 10s., being a restricted price, does not measure the buyer's estimate of the benefit of the thing to him. This is measured by the 15s. that, *ex hypothesi*, he would have given had there been no control. Hence, while there is a presumption—which may, indeed, in certain circumstances be rebutted—against general bounties, there is a corresponding presumption *in favour of* cancelling bounties. If a cancelling bounty is given, the question from what source the funds for it are taken, whether these are general taxes or excess profits duty raised from the industry making the commodity, or, as at one time happened with British coal, profits made on exports the prices of which are free from control, is of secondary importance.

CHAPTER XII

RATIONING OF CONSUMERS

1. THE idea which the term 'rationing' is most likely to call up in the ordinary mind in England is the fixing of maximum weekly rations for individual purchasers of certain foods. This type of rationing might, theoretically, be introduced without any accompanying price control, in order to conserve sufficient supplies of some important commodity for poor persons as against better-to-do persons, who would otherwise force up the price and take nearly all that there is. Of course, limitation by rationing, or in any other way, of the purchases permitted to the well-to-do will, just like a limitation of price, indirectly cause the output of the commodity affected to fall somewhat below what it would otherwise have been. But, at all events in short periods, where diminished production is not likely to be associated with increased costs per unit, the contraction of output will be smaller than the contraction in rich people's purchases, and poor people will get more of the commodity at lower prices than would have been available for them in a completely free

market. It must be remembered, however, that, since the rich are relatively few in number, and since their consumption of common articles—except coal, the consumption of which is regulated by the size of a man's house and not by his bodily capacity—is a small proportion of the whole, a very large percentage cut in their *per capita* purchases would make possible only a very small percentage addition to the *per capita* consumption to the poor. Moreover, against any benefit that might be obtained through this there has to be set a large adverse balance of irritation and inconvenience, and, perhaps, of unavoidable muddling on the part of the supervising officials. The practical inference seems to be that, in the absence of a system of price control, while it may redound slightly to the general interest for well-to-do persons voluntarily to restrict their purchases of certain common articles in times of shortage, yet, in the present state of economic knowledge and administrative efficiency, it may easily do more harm than good for the State to force them to do this.

2. In fact, in the Great War, the rationing introduced in this country was designed to complement the system of maximum prices so as to prevent that system from leading to chaos in distribution. If a commodity, the price of which is restricted, is being produced under conditions of monopoly, there is indeed, unlikely to be chaos in any event. For the State to enforce a maximum price less than monopoly price, but not less than the price that would allow normal profits, will have the effect of calling out at

once more purchases and more output. The quantity available for sale will still be equal to the quantity demanded at the price that is being charged. This quantity will, of course, be larger (and the price lower) than it would have been if the government had done nothing; but there will still be equilibrium. When, however, a commodity is being produced under competitive conditions, maximum prices, if they are to have any effect at all, must be fixed below the demand price of the quantity that is being offered for sale; otherwise, being higher than the prices that would have been charged naturally, they will be otiose. When, however, maximum prices for competitive goods are established at a level below what would rule in a free market, unless there is some system of rationing, buyers as a body will be trying to secure at that price more stuff than is available for sale. In a free market price so adjusts itself to the conditions of supply and demand that, at the price established, everybody gets exactly as much as, at that price, he wants. With the fixation of maximum prices (for competitive goods) this automatic regulation of distribution is destroyed.¹ Some people, therefore, must go short of what they want at the regulated price. Who these people will be and how short

¹ When a thing is produced at intervals—*e.g.* the wheat crop—for a continuous demand, maximum prices would not lead to any unsatisfied demand so long as any stock remained; but, unless a scale of ascending maxima were provided to make it worth while for sellers to hold back a part of their supplies from immediate sale, it would lead to the still worse result of complete exhaustion of the crop before next harvest.

they will go depends on a mixture of accident, ability to arrive first at a place of sale and the possession or otherwise of power to influence shopkeepers. It is probable that rich people will, in practice, have an advantage over poor people, because, since they are more valuable customers, shopkeepers may be more anxious to oblige them. Realisation of this fact is naturally very irritating to poor people—more irritating than a knowledge that the rich are getting the stuff, while they are not, under régime of uncontrolled high prices—and the desire to obviate this source of irritation may play a part in deciding politicians to adopt a policy of rationing in war time. As a matter of hard fact, however, as has already been indicated, the proportion of the total supplies of any staple article of food (though, perhaps, not of household coal) that is consumed by rich people is so small that very little difference would be made to the poor if they were allowed to take all they required. Hence, the main objection to the system of price maxima unaccompanied by rationing is, not that it renders the fixation of maximum prices valueless to the mass of the population because the rich, through the exercise of various pulls, will sweep the market bare, but that it leaves distribution chaotic *within* the mass of the population. This chaos is, of course, tempered by unofficial rationing at the discretion of shopkeepers, who will try to keep something for all their regular customers; and, for articles of a sort that people who fail to secure supplies can fairly easily do without, perhaps chaos so tempered is a lesser evil than official rationing.

A number of articles, such as cheese, fish, potatoes and eggs, were subjected during the war to maximum price regulation, but were not rationed. For the main staple articles of food, however—other than bread, which was subsidised and the maximum price for which did not involve a demand in excess of the supply—maximum prices alone led to a struggle to secure a share of the limited supplies so keen, and to suffering on the part of those who failed so serious, that social peace was threatened. Against these evils rationing of staple foods was sought as a remedy.

3. When rationing has been decided upon, it becomes necessary to determine on what principle rations shall be allocated. A system can be imagined under which the fundamental thing aimed at should be *equality of sacrifice* among the different purchasers whose purchases have to be cut down. This system would involve some cut in the purchases even of the very poorest people, and would leave to rich people very much larger rations than were allowed to the poor. In a democracy, in a time of stress sufficiently intense to warrant any form of rationing, this would never be tolerated. If rationing is introduced at all, it must at least *appear* to aim at a quite different fundamental end, namely, *minimum aggregate sacrifice*. This implies the allocation of rations in such a way that the last unit of commodity permitted to any one purchaser shall carry about the same satisfaction as the last permitted to any other, or, more broadly, an adjustment of rations based on *needs* rather than on demands.

For some purposes, objective tests of these may be resorted to. Thus, in the Great War, for coal, gas and electricity a test of this kind was sought in the number and size of rooms and the number of inhabitants in different people's houses. For food products rough tests of need are available in sex, age and occupation. Thus, supplementary rations of some things may be allowed to soldiers, sailors, heavy workers, invalids and children. Naturally, however, considerations of simplicity and administrative convenience point strongly towards the cruder plan of making mere existence the test and allowing equal rations to the whole civilian population. For most purposes in the Great War it was felt that this plan was on the whole the least unsatisfactory. Of course, it is very far from perfect. Normally, "the proportions in which families of equal means use the different 'necessaries of life' are very different. In ordinary times they distribute their expenditure among the different necessaries in the measure which seems best, some getting more bread, some more meat and milk, and so on. By equal rationing all this variety is done away with; each household is given the same amount per head of each commodity; allowances for age, sex, occupation and other things can only be introduced with difficulty."¹ In British food rationing an attempt was made to meet these difficulties by various devices, as, for example, by the granting of special rations of butter and bread to vegetarians. At best, however, the adjustments made in this

¹ Cannan, *Economic Journal*, December, 1917, p. 468.

way must be very rough. For certain things it may be possible to adapt rations directly to the special circumstances of separate individuals. For example, when a man wished, during the later stages of the war, to spend more than £500 on building or redecorating his house, or when he wished to spend anything on structural steel in house building, he had to obtain a licence. The licensing authorities were thus, in effect, allowed to assign rations of building materials and labour varying with their judgement of the needs of individual applicants. Plainly, however, this plan would be administratively unworkable for the generality of ordinary commodities. Rationing, if introduced at all, must be by general rules. Such rationing is hardly practicable on a large scale except for things that people are accustomed to buy regularly and continuously, and for which enormous divergences of need do not exist. Rationing of things like pianos and bicycles, or even of suits of clothes, which people buy at irregular intervals, would be exceedingly difficult.

4. All these things being understood, let us now suppose that it has been decided to introduce a policy of uniform rations of certain articles. Plainly, this policy will fail of its purpose if the rations are fixed so high that, in spite of them, there is not enough of the rationed commodity to satisfy the sum of people's demands at the fixed maximum price. For then some people must go short, and there may still be battles in queues. It follows that, where rationing is introduced in conjunction with

maximum prices, the rations must be allocated with the intention of enabling all demands within the rations to be satisfied. If a mistake is made in this matter, either the ration or the level of the controlled price must forthwith be altered. No government in its senses would adopt rationing as a remedy against queues, and then frame its rationing rules in a way that prevented the supposed remedy from working. Hence, rationing other than effective rationing in this sense, though a theoretical possibility, is a practical monstrosity that is bound to be stillborn. This implies as a corollary that, if the available supplies are, for any reason, cut down in amount, the rations permitted will have to be reduced correspondingly.

5. Now, of course, if a government chose, it could, besides fixing maximum rations, also secure that everyone should wish to buy his full ration, by providing anyone in need with money to do so. Something very like this was in fact done in the Great War, not, indeed, as between individuals, but as between States. For the United Kingdom and the United States, by providing loans for France, Italy and other Allies, made it possible for them to take up the 'rations' of imported wheat and other essential articles that were allotted to them by the various inter-allied commissions. Had it not been for these loans, certain of the rationed States could not have afforded to purchase their ration. Among individuals there is nothing to correspond to inter-allied loans, and in fact many persons, on account of poverty or competing purposes, could not afford,

or, what for the present purpose is the same thing, did not choose, to take up their full quota of certain rationed articles. This circumstance complicated the administrative problem a good deal. It was known that some potential demands would not materialise ; but it was not known how extensive in any week these would be. It was necessary, therefore, for the authorities charged with regulating distribution to see that, in each district, there were always sufficient supplies to satisfy the maximum of demands within the ration limit that experience showed were at all likely to materialise. This necessity meant that, on some occasions in some places, the supplies were sure to exceed the ration demand. Out of this fact a difficult issue arose. It is possible (1) to maintain rigidly the rule that nobody shall be permitted to buy in any week more than the allotted ration ; or (2) to allow the whole, or a part, of any surplus created by the failure of some persons to purchase the full amount of their ration to be sold to people anxious to buy, even though they have already a full ration. Choice has to be made between these two plans.

6. Let us begin by considering a durable article like sugar. If the supplies are sufficient to allow a total distribution throughout the country of, say, 15 million lb. per week, it is plainly better to fix the ration at such a level that, at the regulated price, the whole of these 15 million lb. will be absorbed under the rationing scheme than to fix the ration lower than this and allow the resulting surplus to be distributed outside that scheme. For any extra-

ration supplies could only be distributed on a basis of accident, early inquiry or favouritism ; and these are apt to be even worse regulators than rules of uniformity. Practically the choice is between permitting surplus distribution and having a smaller ration, and forbidding such distribution and having a larger ration. Moreover, if surplus distribution is permitted, there is danger of inequality between districts. Rich people in poor districts will find themselves more liberally supplied, because there is a bigger margin of unpurchased rations allotted to the poor, than rich people in rich districts. Yet again, there will be less inducement for producers and dealers to send stuff from districts where it is plentiful to districts where it is scarce ; they may reckon to sell it as surplus in the district where it is grown and so save the trouble and cost of sending it away. The result may be that in some districts, unless the government intervenes very actively, there may not be enough supplies to satisfy demands within the ration. In principle, therefore, for durable goods no distribution of surplus outside the ration scheme should be allowed.

7. To work out this principle in practice is, however, technically rather difficult. If shopkeepers are merely required to sell no more of some article in a week than the official ration multiplied by the number of their registered customers, the supplies to be allotted to them are easily determined, and departures on their part from the law can be detected by simple methods. But, if their sales are limited to the above quantity *minus* such part of the

supplies allowed to them as their customers fail to buy, mere registration of customers is no longer sufficient, and it becomes necessary to institute a system of ration books divided into coupons. The shopkeeper's permitted sales are then measured for any period by the number of coupons he has collected. To test obedience to the law it is, therefore, necessary for officials to be appointed to *count* the coupons collected by an enormous number of shopkeepers ; and this is a serious undertaking. Moreover, it is bound to be very difficult to prevent coupons that one person does not use being transferred in one way or another for the use of other people. If the coupon books are deposited with shopkeepers, they are free themselves, with the connivance of their customers, to arrange this. Alternatively, with the connivance of the shopkeeper one purchaser may give or sell some of his coupons to another purchaser. When the sense of public duty is keen, evasions of this kind may not, however, be practised extensively. Moreover, even a considerable risk of evasion may be worth accepting in preference to surrendering a sound principle. The practical inference seems to be that rationing schemes should be drawn up on a basis of absolute maxima, that some evasion of them must be expected, but that the controlling authorities, by inspection and, if need be, by prosecution, should endeavour, so far as may be, to keep this in bounds.

8. When we have to do with articles that are not durable but are liable to perish if not consumed immediately, the balance of advantage is inclined

differently. For then, since it is impossible to secure that in every district every week the supplies shall exactly fit the rationed demand, if the surplus were not allowed to be sold it would be wasted. No doubt, this danger could be minimised by skilful distribution of supplies among different localities. Furthermore, when a surplus appeared in some district, it might be possible to dispose of most of it to persons who had not taken up the whole of their ration by cutting prices sharply. This device, however, would be a difficult one to apply systematically, because, so applied, it would tempt people to hold up their demand till the last moment, so as to come in on the cut, and this would disorganise the whole system. Probably for this reason the device was not adopted in any English rationing scheme. Instead, when perishable articles were in question, provisional, and not absolute, maxima were fixed. Thus, if their supply of meat offals or of butter were not absorbed in any week by the rationed demand, retailers were allowed to sell the surplus to people whose ration was already complete. It was the business of the central distributing authorities to see that surpluses of this sort were as small and rare as possible. It is interesting to observe that an exactly analogous problem was presented in the rationing of ship space to different sorts of articles : for to forbid ships absolutely to bring in certain relatively unimportant things might sometimes mean their return half empty, though a cargo of these things, not in any way competing with a more useful cargo, was available.

9. Hitherto, we have tacitly assumed that rationed commodities are all simple uniform things. In reality, of course, this is not so. The problem has to be faced of how to treat articles of which there are various grades of quality. A partial solution of this problem was found by fixing the ration in terms of expenditure instead of quantity. With a simple thing when the price is given, the choice between a quantity ration and an expenditure ration is obviously immaterial. But, when there are several qualities, an expenditure ration enables purchases to be limited generally without dictation as to people's choice of quality. Thus in England a ration ticket allowed the purchase of so much value of meat, the different joints being priced according to an official scale. Had tea been rationed, the same system would probably have been pursued. There is the difficulty, however, that, if the more expensive qualities owe their greater value to their taste, so that sixpence-worth has much less nutritive effect, everybody may be driven to demand the cheaper varieties. When all varieties are produced by a joint process, as with meat, this will force a revision of the official prices if waste is to be avoided. Moreover, for commodities the prices of which vary with distance in time from the period of harvest, rationing by expenditure means periodic changes in the expenditure allowance if the quantity ration is to be kept constant.

10. Finally, a word should be said on an important point in the technique of administration. When a commodity which it is decided to ration is

handled by private dealers inside the country, it is extraordinarily difficult to prevent these persons from exceeding their allotted ration. This difficulty was very important in Germany during the war. The farmers who handled the main part of the nation's food supply, and who were very numerous, by refusing to stint themselves were free to starve the towns. So far as meat is concerned, attempts may be made to prevent evasion by rules forbidding the private slaughtering of animals, but it is easy for a farmer, if he wishes to do so, to break these rules without being detected. When supplies are mainly imported this difficulty is relatively small. Of course, the various middlemen between importers and buyers, *e.g.*, butchers, shopkeepers and millers, may take too much of the rationed article for their personal consumption, unless the government succeeds in making them account accurately for their sales. With meat, this is hardly possible, even if the government itself buys cattle from farmers and sells to butchers. But, unlike producing farmers, middlemen in meat are bound to be a small part of the whole population. Failure to keep them to their ration is, therefore, not nearly so serious a matter.

CHAPTER XIII

PRIORITIES AND THE RATIONING OF FIRMS

1. THE discussion of the previous chapter does not exhaust the distributional problem to which price control gives rise. So far we have considered this problem as being concerned exclusively with distribution among people:—the supply at the regulated price being insufficient to satisfy the demands of all consumers, some consumers had to have their demands cut down. This line of thought proceeds as though each consumer's demand were a single homogeneous thing. For some commodities, however, the aggregate demand of most consumers is made up of several demands directed to different uses which the commodities may be made to serve. For commodities of this sort it may be that the necessary restriction of demand can be brought about most satisfactorily by regulating distribution among uses instead of, or as well as, distribution among people irrespective of uses. Naturally this form of regulation is more readily applicable to simple materials that are capable of being devoted to a number of different ends than to highly specialised finished goods.

2. As between different uses open to materials the war-time regulations could, of course, only be based on some rough criterion of relative national importance. The simplest way to work this criterion was, when a material was short, to forbid altogether its employment in certain uses that were clearly unimportant. Examples of this kind of regulation in the Great War were :

(1) The prohibition of the use of petrol for pleasure-touring :

(2) The prohibition of the use of paper for newspaper contents bills and, under certain conditions, traders' circulars, and the abolition of ' returns ' :

(3) The prohibition by the Timber Supplies Department against packing various articles in wooden cases and crates :

(4) The prohibition of the use of electricity for lighting shop fronts, and the order restricting the hours during which hotel and restaurant dining-rooms might use artificial light or theatres might remain open.

These simple prohibitions accomplished something ; but, when the volume of supply or the requirements of the government and different sorts of non-government uses were liable to vary, the mere prohibition of particular uses was not adequate. Resort was had to a system of priority among uses. A scale of Priority Certificates was instituted, which only permitted sales to would-be buyers with certificates of lower urgency after those with certificates of higher urgency had been satisfied. Work for government had the first grade of certificate,

work of special national importance (*e.g.* export work, deemed valuable for protecting the foreign exchanges) the next, and so on in successive stages. Iron and steel products were dealt with on this plan, and quarry stone and other road material on less elaborate, but substantially equivalent, lines. So also were imported flax and leather and a number of metals. Whatever the precise plan followed, the essence of it is the construction of a scale of urgency amongst uses, the less urgent being sacrificed to the more urgent. This system is obviously preferable to chaos, but it is open to a serious objection. The intention is to withdraw such supplies as have to be withdrawn from the least urgent uses, leaving more urgent uses with access to them. But, in fact, there is no such thing as urgency of use in an abstract general way without reference to the quantity of different people's holdings. The first unit devoted by anybody to a comparatively non-essential use will often serve a more urgent need than the last devoted to a comparatively essential one. Everybody would agree that water is much more urgently wanted for drinking than for washing. But to prohibit a man from using any water at all for washing while allowing him an ample supply for drinking would probably have bad results: he would prefer to do some washing even though, in consequence, he had rather less to drink. It follows that the system of cutting off certain uses is wasteful of satisfaction. Some of the waste may, however, be obviated if departures from the general rule are permitted in special circumstances under

licence ; and, in any event, the sum total of waste may well be less than it would be if the system of regulation imposed disregarded differences of urgency among uses altogether.

3. It should be added that there may be great administrative difficulty in preventing people from using things nominally bought for one purpose for another purpose. Thus, a housewife, who is granted so much sugar for jam-making and chooses to use a part of it for ordinary consumption, is not easily detected or punished. When, however, as was usual in the war, regulations are operated through producers instead of being applied directly to consumers, *e.g.* when bakers are forbidden to use wheat, flour or sugar in making confectionery, or builders to use steel in building houses, they are more easily enforceable.

4. When distribution among uses has been regulated, there still remains, for materials that have to undergo a process of manufacture, the problem of regulating distribution among the firms that wish to work them up. With restricted prices, if nothing were done, this distribution also would be chaotic, depending on accident, good fortune or favouritism. To this government regulation will often be preferable. Regulation implies, however, the choice of some criterion in accordance with which regulation shall be worked. The British Government during the war adopted the criterion of pre-war purchases. The use of this criterion is illustrated by the rules of the Cotton Control Board (1918) limiting the proportion of machinery that any firm might keep

at work on American cotton, and by the condition imposed on importers by the Paper Control, that they should supply their customers (*i.e.* manufacturers) in the same proportions as in 1916-17. In highly organised trades like the cotton industry there was no technical difficulty in applying regulations on these lines, but in many of the metal trades a special organisation had to be created for the purpose. It is clear that this basis of allocation could not be employed in connection with any policy designed to last for more than a short period. For an arrangement, which tended to maintain the various firms engaged in an industry always in the same relative position as they occupied in an arbitrarily chosen year, would constitute a quite intolerable obstacle to efficiency and progress. For regulation designed to be temporary, it was, however, sufficiently satisfactory.

CHAPTER XIV

SUBSIDIES

1. IT will be remembered that in the concluding sentences of Chapter XI. a distinction was drawn between the cancelling bounties discussed in that chapter and general bounties. Something will now be said of these general bounties. There are two principal occasions for them. First, certain 'short' commodities are largely imported from abroad. The price of these things, as from the foreign sellers, cannot be controlled by legislation in the importing country; for attempts to control it would merely lead those sellers to send their stuff to other markets. Hence, high prices of these things cannot be prevented by mere decree. Secondly, for certain things produced at home, conditions may become such that very high prices are necessary even to yield ordinary profit without any 'profiteering.' These high prices cannot be cut down by decree without causing supply to fall off very seriously. It may happen, however, that things in one or other of these two classes—in the United Kingdom wheat is an example of the first class, potatoes of the second

—are largely consumed by very poor people, and that high charges for them would lead to an amount of discontent that government in war time dare not face. In these circumstances it is open to government to lower prices to consumers by itself paying part of the price asked for by producers. It can do this either by buying up the product from producers and reselling it at a loss to consumers or by offering a bounty of so much per unit sold in the country. Whichever of these things it does, it is, in effect, giving a present proportioned to purchases to the consumers of the bounty-fed article. Obviously, no government will choose for this kind of treatment any commodities except such as are largely consumed by very poor persons.

2. Apart from the fact, to be referred to presently, that in war time the funds for these subsidies are likely to be obtained by the creation of bank credits, whereas in normal times they will come out of taxes, a policy of subsidies on poor men's goods is economically no different as a war-time measure from what it is as a peace-time measure. The advantages and disadvantages attaching to it may, therefore, be considered in a quite general way. The bounties may take either of two forms : first, bounties on the whole consumption of particular commodities which are predominantly purchased by poor persons ; secondly, bounties confined to that part of the whole consumption which is actually enjoyed by defined categories of poor persons. The first of these methods is illustrated by the special subsidies which were paid on bread and potatoes during the Great War to

enable prices to be kept down to what was considered a 'reasonable' level; the second by the Irish Labourers Act, under which, not all house-building in the districts affected, but only house-building for labourers, is subsidised, and by the more general arrangements which have been adopted to meet the post-war house shortage. I propose to compare these two methods, first, with one another, and, secondly, with grants to poor persons made directly instead of on their purchases of particular commodities.

3. A bounty limited to that part of the output of anything that is actually bought by poor persons has the advantage over a general bounty that it saves transferring purchasing power in the first instance from better-to-do people to the State and then back again to these better-to-do people on their purchases. For this transfer and return must involve in normal times additional taxation and consequent discouragement to production, and in war time additional credit creation with the evils attaching to that. This is the same advantage that a system of old age pensions confined to poor persons has over universal old age pensions. On the other hand, limited bounties have the disadvantage that under them the charity element is more obvious; and the further disadvantage that, unless the line between potential beneficiaries and others is skilfully drawn, some people may be inclined voluntarily to relax their productive efforts in order to qualify for inclusion in the category of poor persons. Moreover, when it is a question of giving a bounty in respect

of purchases of any ordinary article of merchandise, as distinguished from such personal goods as houses, education and insurance, it is practically very difficult to confine the bounty to one set of buyers only ; for, if this were done, the privileged buyers would find a profit in setting up as middlemen on behalf of others.

4. We have next to compare a bounty on a particular article, whether universal or confined to the purchases of the poor, with more direct forms of help to the poor. If the amount of the bounty-fed commodity which each recipient is to consume is fixed authoritatively, as under the British system of free and compulsory education, a gift of so much money's worth in payment for the bounty-fed commodity has the same effect as an equal gift made directly. The same thing is true if the amount of the commodity which anybody purchases is not fixed authoritatively, but is, for some other reason, not liable to change in consequence of the bounty. Thus, poor people are accustomed to buy some things through a common purchase fund, so organised that the payment a member has to make does not vary with the amount of his individual purchases. Sick clubs are arranged on this plan. There will be no inducement to a member of a sick club to increase the amount of the doctor's services that he calls for in a year merely because the fixed amount that he has been accustomed to pay for membership of the club is taken over and paid by the State. These conditions, however, are exceptional. In general, when a bounty, or the equivalent of a bounty, is

given on any commodity, the beneficiaries of the bounty will buy more of it than they would have done had they received an equal amount of money and were free to spend it as they chose. In this way resources are diverted out of the natural channels of production, and there is a presumption that this diversion will involve a waste of economic resources and a loss of satisfaction on the whole. This presumption is not, however, absolute. The bounty method may still sometimes be better, not only because there may be special economic or non-economic reasons for encouraging the consumption of the particular thing on which the bounty is given, but also because the element of "charity" is less obvious and, therefore, less damaging to the *morale* of the beneficiaries, when it is concealed in a bounty than when it is displayed in a direct dole.

5. There remains the special point, referred to in section 2, that in war time subsidies are likely to be furnished out of credit creation. As has been explained in an earlier chapter, this method of raising funds is equivalent to raising them by taxation proportioned to income. Such taxation hits poor persons very hardly. The object of the subsidy is to reduce the cost of living to these persons; but the process of obtaining the funds for it raises the cost of everything that they buy except the subsidised thing. Consequently, when it is designed to help poor people in a given measure by means of a subsidy, say, on bread, it will always be found that they are in fact helped less than was intended; and either

this fact will have to be accepted or a further subsidy, either on bread or on something else, will have to be given to counteract the untoward indirect consequences of the original subsidy. This further subsidy will, in turn, set up other untoward indirect consequences, which will, in turn, need cancelling. Subsidies granted out of taxes, as in normal times they naturally will be, are free from this complication.

CHAPTER XV

THE AFTERMATH IN CURRENCY AND EXCHANGES

1. IF the creation of bank credits is an objectionable method of financing a war, it is an intolerable method of financing the normal processes of peace. So long as it continues, it involves, as has been explained, the levy of concealed taxation proportioned to income, the shifting of wealth from receivers of fixed income to others, and perpetual difficulty in adjusting the wages of work-people to always rising prices. It involves, too, in consonance with the upward movement of prices, a growing depreciation of the exchanges with gold standard countries, and, by engendering uncertainty both about future prices and about future rates of exchange, it seriously hampers trade contracts and, through them, industry. If the process of debasement is carried far enough, people will come to distrust the government currency altogether; it will become practically valueless, and the whole industrial life of the country will be disarranged. Farmers, for example, not caring to sell wheat for worthless paper, and not being able easily to barter it directly for goods, will be tempted only

to grow enough of it for their own requirements. Other producers will be affected in the same way. There will be government bankruptcy and industrial collapse, and the whole laborious edifice of modern economic life will have to be built up again from the beginning. In the light of these considerations, nobody doubts that, at the earliest possible moment when a war is over, governments should cease financing themselves by further creations of bank credits. No doubt, the calls upon them may be so enormous, as, for example, in Germany and Austria under the Peace Treaty, that it is politically impossible for any government to maintain itself in power and at the same time to levy, in an unconcealed form, sufficient taxes, or to raise sufficient loans to enable it to meet its international obligations and also to pay its way. If this is so, continued finance by bank credits will be unavoidable, in spite of the abyss to which it is sure to lead. This consideration may well suggest the propriety of international action designed to ease the burden of certain distressed nations ; but it affords no argument against the view that, as soon as possible, every government should cease to resort to credit creations as a source of money income.

2. The cessation of credit creations to finance government does not, however, by itself necessarily suffice to stop continued credit expansion. The process of currency depreciation, which finance by bank credits has started, may, unless further remedial steps are taken, continue under its own momentum even after the initiating cause has been shut off. The most prominent source of danger is floating

debt in the form, in this country, of Treasury bills. The government may not only have stopped raising new money by bank credits, but may have ceased borrowing altogether and be paying its way out of taxation. Even then it may, on occasions, find itself forced to use credit creation at the Bank of England as the only means of repaying short-time advances which the public and the banks decline to renew. Thus, if 100 millions of Treasury bills fall due for repayment at any time, and, instead of renewing them, the public put the proceeds of the repaid bills to their deposit credits, or, so far as it is banks who held the bills, if the bankers lend 100 millions more to the public instead of renewing them, the government will be forced to borrow 100 millions on Ways and Means from the Bank of England. This means indirectly an increase by 100 millions of bankers' balances at the Bank of England against an unchanged amount of liabilities. The bankers (outside the Bank of England) are, therefore, able, if they choose, without weakening their proportion, to increase their liabilities by no less than 400 millions more, and the doors are open for new credit expansion. The only way in which the government can prevent this is by offering a rate of interest sufficiently high to ensure that Treasury bills falling due shall be renewed. Very likely, however, they may hesitate before offering a very high rate for these bills, since this must naturally carry with it very high rates for money generally. Hence, for complete protection against further credit expansion, it is necessary that, besides stopping new creations to

finance new expenditure, the government should, as soon as practicable, fund, or pay off, floating debt in the form of Treasury bills and any other short-time obligations due from it otherwise than to the Bank of England.¹

3. At first sight it might be thought that in England the basis of the credit structure could also be enlarged in another way. The war broke down the rules by which the issue of fiduciary currency was limited. It was open to bankers to exchange their balances at the Bank of England against new currency notes to an unlimited extent. During the war these balances, as explained in Chapter X., came back into the Bank of England when the government spent them, so that bankers' reserves were increased by the full amount of the notes they held themselves and did not pass on to the public. After the war, however, things became different. When the government had ceased to finance itself through banks, the balances paid to it in exchange for notes would

¹ The funding of that portion of the floating debt which consists in Ways and Means advances from the Bank of England would have a different effect from the funding of Treasury bills. If 50 millions were raised from the public on a long loan and employed to extinguish these advances, the deposits of bankers and also their balances at the Bank of England would be reduced by 50 millions. In order to maintain their proportion they would need to cut down their loans to the public by no less than 200 millions, unless the Bank of England was prepared to lend to their late customers. If it made new loans to these people equal to the 50 millions it had been lending to the government, these 50 millions would come into the balances of the banks, and the basis of the credit structure would be exactly the same as it was before.

probably be used to wipe out Ways and Means debt to the Bank of England. These balances, therefore, would not reappear in the credit account of the bankers at the Bank of England, and, consequently, the reserves of bankers, instead of being increased, would merely be converted from the form of balances at the Bank of England into the form of currency notes. Hence, the device of buying notes with balances would not, after the government had ceased to rely on bankers' loans to finance its purchases, enlarge the basis of the credit structure.

4. We have then only one way in which this basis is liable to be enlarged, and this way itself may be eliminated by the funding of Treasury bills. Expansion of bank credit is, however, capable of being brought about, not only when the basis of credit is enlarged and the proportion of bankers' reserves to liabilities retained, but also when the basis of credit is unaltered and the proportion of liabilities to reserves is enlarged. As was explained in Chapter X., both methods of expansion alike are held in check in normal times by the fact that the rise of prices engendered by them sets up a drain on the gold reserve of the Bank of England, thus forcing up the Bank of England discount rate directly and the market rate indirectly. The system of selling currency notes against bank balances removes this check to credit expansion. It enables the bankers to convert their balances into currency notes instead of into Bank of England notes. Consequently, the reserve of the Bank of England is not depleted, and the forces making for a rise in money rates and a

consequent check to credits are not set in play. In these circumstances there is nothing to prevent the creation of continually growing credits through an increase in the proportion of bankers' liabilities to their cash (in hand and at the Bank of England) on behalf of private borrowers. If this is to be stopped, a further step is required over and above the cessation of credit creations in favour of government and the funding of Treasury bills. This step may be either the enforcement of a high bank rate or the prohibition of further manufacture of fiduciary notes. The former method (high bank rate) leads indirectly to a stoppage of note manufacture; and the latter method (stoppage of note manufacture) leads indirectly to a high bank rate. They are really two paths to the same end. If credit expansion is proceeding rapidly, it may be wise to begin operating through bank rate in a gradual manner, and then to crown the movement by a legal limitation on the note issue. In December 1919 a limit through Treasury Minute—not a formal legal limit—was imposed in the United Kingdom on any further issue of fiduciary currency notes beyond a maximum of 320 millions.

5. The danger of continuing credit expansion is not, however, the only monetary aftermath of war. Let it be granted that a halt to further advance has been successfully called. This does not mean that all is right again. The system of war finance adopted by practically all European countries involved the collapse of the gold standard. In the United Kingdom currency notes were kept nomin-

ally convertible into sovereigns, but the melting of sovereigns was prohibited, and ²⁻the export of gold was barred, during the war by fear of submarines, and, after the Armistice, by governmental regulation. These things broke the tie that bound currency to bullion. A £ note was still necessarily worth a sovereign, but both a £ note and a sovereign were free to assume any value *in terms of bullion* between their face value and nothing at all. This implied that sterling (and the same thing is true of francs and lire) was liable to assume any value *in terms of the currency of gold standard countries* between its face value and nothing at all. In other words, the sterling exchange with dollars was liable to fluctuate to any extent between 4.86 dollars to a £ and an indefinitely small quantity of dollars to a £. The wide range of fluctuation thus opened up involves a serious injury to trade. An Englishman will hesitate to sell goods in America if he does not know how much sterling their dollar price will yield him when it comes to be paid; and an American will hesitate in the same way about sales in England. No doubt, it is possible for traders in various ways to insure themselves against loss on exchange fluctuations, but the insurance costs money and so is itself a handicap. Nor does the collapse of the gold standard in Europe merely mean obstacles to trade between Europe and gold standard countries. The various European currencies do not, of course, fluctuate from gold parity on a common plan, but independently and diversely. Thus, exchanges are rendered unstable, not merely with gold standard

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countries, but also with one another. It is an urgent need of industry to narrow the range of exchange fluctuation between the various countries of the world.

6. It is theoretically possible for any country on an inconvertible paper basis to maintain the exchange between its currency and the currency of any other country in the neighbourhood of any parity it chooses by operating, through control of money rates or currency issues, on its own internal price level. If every country in which the gold standard has broken down were to select some parity with dollars and, by internal currency manipulation, to maintain it, we should have again a system of nearly stable foreign exchanges. Theoretically, this kind of system could be established without a restoration of the gold standard in any sense; and it is not even necessary that the currency of a country which is used as a base for others should be a gold standard currency. A whole world of nations, each with separate inconvertible currencies, could, if their governments were sufficiently firm and able, maintain a system of approximately stable foreign exchanges. Practically, however, in the present state of the world, governments are not strong enough, nor yet sufficiently trusted, for a system of this kind to be likely to work. Something less directly dependent upon the conduct of politicians is needed. The best way to lessen exchange fluctuations in actual conditions is, as it seems to me, to aim at the restoration in as many countries as possible of an effective gold standard, under

which gold shall again be freely obtainable for export at a fixed parity with currency. This would give the same sort of stability as existed before the war to the exchanges, among themselves and with countries already on a gold standard, of all the countries that adopted it. There is, of course, no necessity under this system for gold to be made available in the form of coin for purposes of internal circulation.

7. The restoration in any country of an effective gold standard does not imply the restoration of the pre-war parity between its currency and gold. It is possible to de-valuate a currency, to make paper £s or francs or lire or marks convertible into a smaller quantity of gold than they were convertible into before the war, and then, on this lower basis, to reopen the doors for gold export. Here a large issue is raised. Let us consider a country in which, as in the United Kingdom, new credit creations have come to an end—until this has happened it is obvious that no further step can be taken—and the process of currency depreciation has thereby been stopped. Ought such a country to 'de-valuate' its currency on the basis of the existing exchange, to try and get back to pre-war parity, or to aim at some parity intermediate between the present gold parity of its currency and the pre-war parity?

8. The first step towards answering this question is to distinguish between different elements of which a given existing exchange depreciation may be made up. If English prices generally had been doubled

owing to currency changes, while American prices were unaltered, and if nothing else had happened, the consequence would be a fall in sterling to half its old value in dollars, and no change at all in the real conditions of trade. This is the sort of adjustment that is contemplated when it is said that exchange rates tend to conform to purchasing power parities. If equilibrium is to be established, it *must* take place; for, if it does not, Englishmen will be getting different quantities of sterling per unit for the same commodities as sold in England and as sold, after allowance has been made for transport and tariff charges, in America. With the adjustment made, England would send the same things as before to America, getting the same amount of dollars; these would be convertible into twice as much sterling as before; and that would buy the same amount of English stuff as the old amount of sterling used to represent. This element in exchange depreciation is primarily a reflection of relative movements of general prices in the two countries, made possible by the removal of the correctives to such movements that operate under an effective gold standard. It is not, however, necessarily the only element present in any actual exchange depreciation. If at any time Englishmen, on account of purchases in America or for any other reason, owe a large number of dollars in New York, and not many bills for dollars drawn by English exporters are available, English debtors will have difficulty in raising the dollars they need. If they cannot get hold of dollar bills, they will have to borrow dollars in New York, perhaps at high

interest. As expressed in the currency of the borrowers' country, this interest is likely to be especially high if Americans fear that the currency of that country will become still further depreciated by a continuance of 'inflationist' finance. In order to avoid the high interest, it will be worth while for Englishmen, Frenchmen, or Italians to pay a higher price for dollar bills than corresponds to purchasing power parity. Hence, when price levels are such that the exchange 'ought' or 'tends' to be at, say, 4 dollars to the £, it may actually be forced to, say, 3.50 dollars. Of course, a fall below purchasing power parity greatly lessens the profit obtainable by Americans in sending goods to England, and greatly increases that obtainable by Englishmen in sending goods to America. Consequently, the lapse below purchasing power parity will start forces making for its own correction. But, particularly in a period when export industries are disorganised and when the need for imports is urgent, this force may operate in a very halting way. Clearly, the accidental and temporary element in exchange depreciation that is thus left over ought to be eliminated from our calculations when the problem of selecting a permanent gold parity is under discussion. Nobody would propose to adopt a gold parity lower than is required to conform with the existing purchasing power parity. Thus, if the dollar exchange actually stands at 3.50 to the £, but there is reason to believe that 40 per cent of the fall from pre-war parity is accidental and temporary, the lowest new parity that anybody would advocate would be, not 3.50,

but 4 dollars. Existing statistics do not enable us to form estimates, except very tentatively, as to the part of the existing exchange depreciation that is accidental in the above sense, and the part that is fundamental and in congruity with purchasing power parity. *Prima facie* it might be thought that the fundamental part can be isolated by a comparison of the changes in general prices, as shown in index numbers, that have taken place in, say, England and America. Ordinary index numbers, however, refer to the prices of things in general, and not specifically to the smaller group of things that enter into international trade. To know that things in general had quadrupled in price in France and doubled in price in America would not, therefore, enable us to infer that a 50 per cent fall in the dollar value of the franc was required to restore equilibrium. This inference would only be warranted on the assumption that the prices of things in general, as recorded in the index numbers of the two countries, had moved exactly parallel with the prices of the goods actually entering into the international trade; and that assumption cannot properly be made. This difficulty would remain even if the index numbers at present in existence gave perfectly true pictures of movements of the prices of things in general in the countries to which they refer. Actually they do not do this, as is apparent from the fact that different index numbers—the Bureau of Labour and the Bradstreet numbers for the United States, and the Board of Trade, *Statist* and *Economist* numbers for the United Kingdom—

give widely divergent accounts of the prices of things in general. There is, thus, no certain means of distinguishing the fundamental from the accidental elements in the present large depreciations of the European exchanges. If action has to be taken before the commotion due to war has subsided, all we can do is to make a more or less arbitrary allowance for the accidental element in actual exchange rates, and to use the resulting figures as the best representation to be got of the 'proper' exchange rates conformable to purchasing power parity. For the United Kingdom a small allowance—perhaps 10 per cent—would be sufficient. There is reason to suppose, however, that the Austrian, German, Italian and French exchanges are substantially below purchasing power parity, in consequence partly of temporary trade conditions and partly of foreign uncertainty as to the future currency policy of the governments of some of these countries. For them, therefore, a much larger allowance should be made before the 'proper' exchange rate is estimated from the actual rate.

9. Let us start then with some estimated level of the 'proper' exchange rate conformable to the relative purchasing powers of the currency of this country and of the United States, say 4.20 dollars to the £. The question is whether we should de-value our currency to that level, or aim at restoring pre-war parity with gold, or aim at something intermediate between the two. The principal relevant considerations are as follows. In favour of a return to pre-war parity it may be urged that the adoption of any

lower parity would mean deliberate ^{English} governmental depreciation of the currency, and so would reduce general confidence in the financial probity of the devaluating country ; and also that it would be unfair to all lenders at fixed interest whose loans were made before the war or during its earlier stages before the currency had greatly depreciated. On the other side are the troubles and inconveniences of the backward passage. A higher norm of exchange can only be brought about in correspondence with a fall in internal, as compared with external, (gold) prices. Such a relative fall may be induced by (1) a growth in production here at a greater rate than in America, or (2) a contraction of credits and currency here relatively to America. In view of the fact that British industry has been more seriously dislocated by the war than American industry, something may be hoped for under the former of these two heads. Plainly, however, not very much can be expected from this side, and adjustment must be sought mainly on the side of purchasing power. If America were to adopt the policy of expanding her bank credits and increasing her issues of fiduciary notes, pre-war parity might be restored without any action on the part of this country. American creations of gold substitutes would cause gold to fall in terms of things as much as sterling has already fallen, with the result that gold and sterling would return to their old parity. If, however, as has in fact happened, America does not 'inflate' in this sense, still more if America 'deflates,' the United Kingdom, in order to get back to pre-war parity,

must 'deflate' so far that the ratio of current British prices to pre-war British prices is no longer greater than the ratio of current American prices to pre-war American prices. This implies a reduction in the credit structure and a withdrawal of notes from circulation. It can be brought about either by forcing currency notes into the Bank of England by high money rates and then transmuting them into government securities, or by buying them for destruction from the public or the banks with balances obtained by taxation—a proceeding which would compel the banks to draw on the reserve of the Bank of England and so would force up money rates. The former of these plans has the advantage that under it we know, whereas under the latter plan we do not know, how large the rise in Bank rate is going to be, and so are secure against inadvertently administering a severer shock to business than was intended. But, apart from this, the two plans are essentially one. They both, of course, require, as a supplementary provision, that, after the volume of the fiduciary note issue has been reduced, the reduction shall not be neutralised by a corresponding issue of new notes. To this end it would be possible to enact that, whenever fiduciary notes fell to any amount, that amount should immediately become the legal maximum ; so that a reduction by, say, 5 millions occurring in any week would mean a permanent reduction by 5 millions. This plan would be somewhat stringent. The Cunliffe Committee recommended that the maximum actually attained in any year should be made the legal

maximum of the next year. This plan could only bring about a very slow reduction. A plan intermediate between the two would be to provide that, until the pre-war parity is restored, as and when the actual volume of the fiduciary currency falls, under the influence of a high bank rate or otherwise, the legal maximum should chase it downwards, keeping it always closely in sight. For example, any 10 million fall below the existing legal maximum might automatically bring about a 5 million fall in the legal maximum.¹ All of these methods are devices, from the currency side, for bringing about a reduction in prices. As such, they must, in some degree, discourage industry; and the discouragement will be increased by friction and disputes when attempts are made to lower wages in correspondence with the price fall. The process to be gone through on the return journey to pre-war parity is not a smooth one either for employers, whose dividends will fall, or for wage-earners, whose employment will be threatened. Moreover, the successful accomplishment of it involves afterwards the payment of interest on war

¹ It may, perhaps, be thought at first sight that this plan would create difficulties, at periods of normal seasonal drain, by making the currency rigid. But this is not really so. Five-pound notes would still be available in the banking reserve of the Bank of England for direct use by the public; and if, as would no doubt happen, extra £1 notes were also required, these could always be provided without breach of the law—for the maximum applies only to the fiduciary issue—by a transference to the Currency Note Reserve of £5 notes equal to the aggregate value of new £1 notes that it was desired to issue. The position as regards seasonal demands for extra currency would thus, in substance, be the same as it was before the war.

loans in a currency much more valuable than that in which a large part of them was subscribed. This is, *prima facie*, unfair. It is also, on the fiscal side, exceedingly inconvenient. For, money incomes being reduced in proportion as currency is appreciated, appreciation will make necessary much higher rates of tax for the service of the debt, and this will make more difficult the problem of balancing the budget.

In the light of these considerations it is clear that the case for a return to the pre-war parity is stronger—that is to say, the arguments in favour of it have more, and those against it have less, force—the nearer to this parity the ‘proper’ exchange rate of any country with gold standard countries is, or is expected to be when ‘inflation’ is finally stayed. For the United Kingdom, where the American exchange is only depreciated some 20 per cent, the balance of argument is, I think, in favour of an ultimate and not too long delayed return to pre-war parity; for Austria and probably Germany it points to a substantially lower parity; for Italy and France the issue is less clear, but there can be no doubt that, if a return to pre-war parity is aimed at, the strain will be exceedingly severe, and the process of return must be slow.

10. If any country decides to aim at a new parity lower than the pre-war parity, it will be a matter for consideration whether an attempt should be made to alleviate the hardships of those creditors whose loans date back from before the war by legislation directed to scale up certain classes of

debts, thus converting them into debts of higher nominal amount in terms of the new national money. In view of the frequent changes that take place in the ownership of securities, it would be very difficult to work a plan of this kind satisfactorily. The matter might, perhaps, usefully be studied by an expert commission, but, on the face of things, it seems probable that it would open too wide a door to attempts to unbury the past.

11. When the parity determined upon has been nearly achieved, whether the parity chosen be the pre-war parity or another, it will become possible once more to give gold freely for export in return for currency at the parity that has been fixed upon. This means—whether or not gold is also given in coined form for internal circulation—the restoration of an effective gold standard. There will then be no tendency for gold to be continuously drained abroad, any more than there was before the war. Clearly, however, if discount rates are to be guarded against violent fluctuations on account of temporary drains, the gold held in reserve will need to be of substantial amount relatively to any probable drain; for, otherwise, the presentation of a small absolute quantity of notes to be encashed into gold for export will involve a large proportionate fall in the country's gold reserves. The Committee on Currency and the Foreign Exchanges pointed out that, on certain assumptions, the size of the gold reserve and the size of the fiduciary part of the note issue stand in a definite quantitative relation to one another, and that any given settlement of the one

implies a corresponding settlement of the other. "Assuming the restoration of an effective gold standard, and given the conventional standard of banking practice and the customs of the public as regards the use of currency, the amount of legal tender currency (other than subsidiary coin) which can be kept in circulation, including the currency holdings of the banks and the banking department of the Bank of England, will determine itself automatically, since, if the currency becomes redundant, the rate of discount will fall and prices will rise ; notes will be presented in exchange for gold for export and the volume of the currency will be reduced *pro tanto*. If, on the other hand, the supply of currency falls below current requirements, the rate of discount will rise, prices will fall, gold will be imported and new notes taken out in exchange for it." It was contemplated by the Committee that virtually the whole amount of the currency gold in the country would be held in the central reserve at the Bank of England. In these circumstances, "the total circulation (in the above sense) being automatically determined, it will follow that, the higher the amount fixed for the fiduciary issue (including, of course, the fiduciary part of the Bank of England's notes), the lower will be the amount of the covered issue and, consequently, of the central gold reserve, and *vice versa*, while, if the fiduciary issue was fixed at a figure which proved to be higher than the total requirements of the country for legal tender currency, the covered issue, and, with it, the central gold reserve would disappear altogether. It is clear,

therefore, that the amount of the fiduciary issue must be fixed at a figure low enough to make sure, not merely that there will always be some covered issue, but that there will always be a covered issue of sufficiently substantial amount to secure that the covering gold, which constitutes the central reserve, never falls so low as to give rise to apprehension as to the stability of the gold standard." The Committee suggest that a normal gold reserve of 150 millions would be a reasonable one to aim at; and they accordingly recommend that, "until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for a period of at least a year, the policy of reducing the uncovered note issue as and when opportunity offers should be consistently followed. . . . When the exchanges are working normally on the basis of a minimum reserve of 150 millions, the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists."¹ Presumably, if the position was considered satisfactory, the volume of the fiduciary issue would, thereupon, be fixed permanently at the amount then outstanding.

12. One word of caution must be added. The restoration of an effective gold standard, coupled with the establishment of a normal gold reserve adequate to prevent ordinary drains from causing violent fluctuations in discount, would clear away the technical monetary difficulties left over by the war. There is no reason to suppose, however, that

¹ *Loc. cit.* pp. 9, 10.

it would involve a return to anything like the pre-war level of prices. The war, by causing many countries to use paper for purposes for which they used to use gold, has greatly lowered the demand for gold in terms of things. The new American Banking System, introduced immediately before the war, which substitutes centralised for scattered reserves, has also made large economies of gold possible. The result is a general fall in the real value of gold throughout the world. By slow degrees this fall is likely to be mitigated through the diminution that it will cause in the profitableness and, therefore, in the volume, of gold-mining. Moreover, it may happen that certain countries, which have now little use for gold, may, in reaction against the evils of unregulated paper, again bid for large quantities of gold to renew their currencies. On this matter it is impossible to offer any confident forecast. On the whole we may reasonably expect that ultimately the real value of gold throughout the world will rise substantially above the low level round which, taking good and bad times together, it tends to move now. In the near future, however, whatever action the United Kingdom takes, gold is not likely to attain, or even closely to approach, the purchasing power in terms of things that it possessed in 1914. This implies that, when all the restorative processes contemplated in the preceding pages have been accomplished and our currency is again on a completely 'sound' basis, prices will still stand substantially above the pre-war level.

CHAPTER XVI

THE CONTROL OF IMPORTS AND FOREIGN INVESTMENTS

1. IN connection with the discussion of foreign exchanges carried through in the preceding chapter something should be said of the controls over imports and foreign investments that were widely introduced during the war and still survive in several countries. These controls are usually conceived as remedies or palliatives of adverse foreign exchange rates, and their purpose is supposed to be to make these rates more favourable. This is an inadequate view. It confuses a symptom, which usually, though not necessarily, accompanies a particular malady, with the malady itself. This malady is inability to finance the purchase of, and so to obtain, certain vitally necessary things from abroad. It is easily illustrated from the war experience of this country. Prior to 1914 the United Kingdom was accustomed to import large quantities of food and raw material and to pay for them out of her claims for interest upon loans formerly made by her citizens to foreigners, and out of the proceeds of the sale of current exports of coal, manufactured articles

and shipping and banking services. As a result of the war our need for imports, particularly of munitions and food, both for our own use and for the use of our Allies, enormously increased; while the amount of labour and capital available for making exports to pay for these things diminished. It is true that the gap thus made between our requirements and our means of payment was partly filled by the utilisation of that portion of our claims to interest which we were formerly accustomed to devote to capital investments abroad. But, even so, it was extremely difficult for us to find means of paying for the enormous extra purchases which we desired to make. This was our position during a great part of the war period, as it is the position of more than one country suffering from grave dearth of food and raw materials even at the present time. The fundamental problem is to find some way of financing the importation of vitally necessary foreign supplies. This problem can be solved either by obtaining command over sufficient foreign purchasing power to satisfy all our needs or by conserving such foreign purchasing power as we do obtain command over to finance these things.

2. The means available for obtaining command over foreign purchasing power are (1) the export of goods and securities; (2) the sale of securities, gold or other marketable property abroad; (3) borrowing abroad through ordinary loans; and (4) the sale abroad, presumably to foreign speculators, of national paper money. In the urgency of war and of post-war disorganisation it may well be impracticable

for manufacturers to send abroad export goods in anything like adequate quantities, and the supply of securities or other property saleable to foreigners may not be large enough to fill the gap. Moreover, individual foreigners will not make loans, and foreign speculators will not buy the paper money of countries in need, beyond a strictly limited amount. The resulting difficulty may, however, be got over with the help of foreign government loans. In the period following the entry of the United States into the war down to the Armistice, it was, in fact, got over in this way. The United States Government provided sufficient credits to enable the Allied nations to finance their essential foreign purchases. The immense help that it in this way gave to the Allied cause is, perhaps, inadequately appreciated by general European opinion.

3. As an incidental and secondary consequence of American action, the 'symptom' of adverse foreign exchange was covered up. Under arrangement with the United States the British Government was free to borrow dollars to a practically unlimited extent. On the strength of this it deliberately 'pegged' the American exchange by offering dollars to any British traders who had need of them at the rate of 4.76 dollars to the £. Clearly, with an indefinite supply of dollars available at this rate, nobody would buy at any worse rate. The pegging of sterling in the close neighbourhood of pre-war parity was, thus, rigid and complete; and a similar, though less fully effective, policy was adopted on behalf of the franc and lira exchanges. The

position thus brought about was peculiar, because, in view of the large rise in European prices relatively to American prices, there is reason to believe that the purchasing power parity between British (and still more French and Italian) currency and American currency would have been represented by a figure substantially below that at which the exchanges were actually 'pegged.' The pegging, therefore, involved a lapse from economic equilibrium. It discouraged European exports to America and offered an opportunity for abnormal profit to American traders who were able to sell goods in England, France or Italy. The reason, of course, was that the relative price levels and the exchange rates taken in combination made the number of dollars realisable by such traders from a sale in Europe greater than the number realisable from the same sale in the United States. The lapse from economic equilibrium was able to continue, because the restrictions on importation imposed by European governments in consequence of the shortage of transport rendered it impossible for private traders to take advantage, to more than a very small extent, of the opportunities for profit open to them by selling American goods on private account in Europe. The external prices, that is, the prices in foreign markets, of goods sold to Frenchmen, when translated into francs, were abnormally low relatively to French internal prices; but Frenchmen could not in practice buy things at these external prices, and so the influences, which ordinarily would have prevented them from remaining abnormally low, were unable to operate.

Consequently, the peculiar relations, which existed between relative price levels, trade conditions and rates of exchange till early in 1919, were able to maintain themselves in spite of their paradoxical character.

4. So long as America was prepared to provide dollars on loan to an indefinite extent, the Allies were safeguarded against a failure to obtain essential foreign goods on account of inability to pay for them. In these circumstances it might be thought at first sight that everything was satisfactory and that there could be no need for any government interference with normal trading conditions. This, however, is a false inference. Though, with freedom to borrow indefinitely, wasteful use of foreign purchasing power could not have prevented us from getting essential imports, wasteful use was still very undesirable. For the funds, with which any use that could have been cut off was financed, were, in effect, borrowed on behalf of its citizens by the British Government, and thus were obtained at the cost of piling up a burden of foreign national debt against the future. This source of embarrassment it was clearly undesirable to submit to without compelling reason. Consequently, even when foreign government credits were freely obtainable, it might still be in the national interest to prevent private people from employing any foreign purchasing power, of which they might obtain control, for other than really important ends. When foreign government credits are not freely obtainable, as in many parts of Europe to-day, the case for doing this is evidently

much stronger. For then the penalty for wasting such foreign purchasing power as a country has is no longer merely that its government will have to contract a bigger foreign debt, but that it may be unable to finance, and so to obtain, goods that are required to satisfy absolutely vital needs.

5. The period of the war and the immediately succeeding years have afforded many illustrations of attempts on the part of governments to conserve such foreign purchasing power as they and their citizens have succeeded in acquiring for the purchase of essential foreign goods. These attempts have proceeded by way of prohibition or restriction of (1) the importation of relatively unessential goods and (2) the investment of capital abroad. The first branch of this policy, which, during the war period itself, the grave shortage of shipping space must have forced us to adopt apart altogether from financial considerations, is comparatively simple. There is, indeed, the difficulty already referred to in another connection in Chapter XIII., that the first 1000 £ worth of one thing normally classed as a luxury may really be more urgently needed than the 100th 1000 £ worth of another thing normally classed as a necessary. This sort of consideration precludes us from drawing a sharp line between some things which may, and other things which may not, be imported. But the difficulty can be got over well enough by a system of restriction and licences, under which the importation of different things is limited in different degrees. The second branch of the policy, *i.e.* the prohibition of investment abroad, presents a more

complex administrative problem. If the men of money are prepared loyally to support their government, it may be sufficient simply to prohibit the taking up of new foreign issues and the purchase of securities, whether domestic or foreign, from non-resident foreigners. This was all that was done in the United Kingdom during the war. But recent experience in certain European countries has shown that this arrangement is not water-tight. For it does not prevent an exporter of goods or of securities from leaving the proceeds of his sale on deposit in foreign banks or diverting them to the purchase of foreign capital in foreign markets over which no control can be exercised. It has, therefore, been found necessary in some countries to make permission to export goods conditional upon the exporter either himself undertaking to use the foreign exchange, to which the exports give him a title, in purchasing goods for importation, or upon his selling the foreign exchange to some form of official exchange institution, which, in its turn, only sells it to people who wish to pay for imported goods.

CHAPTER XVII

THE AFTERMATH OF INTERNAL DEBT

1. THE volume of internal debt left over after a war is likely to be larger, the larger were the real costs of conducting the war and the smaller was the part of these costs provided through taxation. It is also likely to be larger, the real costs of the war being given, the more free-handed the government was during the course of the war in paying good prices for the things it bought. In whatever way debt has been incurred, a heavy weight of it causes difficulties and raises the formidable problem of how best it may be dealt with. To give concreteness to the discussion of this question I shall relate it to the actual debt of the United Kingdom. The part of this debt that is external may reasonably be set off against money owed to us from abroad. The aggregate volume of our external claims is larger than that of our external debt, but many of these claims are unlikely to be met. As a convenient round figure, we may put the *effective* debt of the United Kingdom at some 6000 million £ all owed internally. With a debt of this magnitude at 5 per cent, so long

as none of the principal is repaid, 300 million £ will have to be raised every year to provide the interest. Nobody proposes, however, that the principal shall be left outstanding as a debt for ever. A large national debt weakens the financial position of a State and makes it difficult for it to raise money to meet any emergency with which it may be confronted. Consequently, it has always been the policy of prudent governments in time of peace steadily to reduce debt. When the British debt, in the years before the war, stood at the comparatively low figure of 700 million £, there was no dispute about this. Every year more revenue was raised than was needed for current expenditure and the payment of debt interest, and the balance was devoted, through the agency of a 'sinking fund,' to reducing the principal of the debt. A policy at least as strict as this must be followed now. In addition to revenue for interest payment, further revenue must be raised for the repayment of principal. This means that at first we should require, say, 350 millions annually, and then, as the debt is gradually paid off, a smaller annual amount. That is 'orthodox' financial policy. In contrast with it stands the rival policy of a large immediate special levy to redeem debt. That policy agrees with orthodox policy in refusing to allow the principal of the debt to remain outstanding permanently. It differs from it only as regards the period over which repayment should be spread. Whereas orthodox policy would repay a small fraction of the principal debt every year and would

complete repayment in a period of, say, fifty years, the policy of a special levy would repay a very large fraction of the principal—if it were practicable, it would repay the whole—by a single tremendous effort. This is the chief financial issue of the present time, to which all questions of the form and method of a special levy, if it is decided to make one, are subordinate. Is it, on the whole, more to the national advantage to discharge a great slice of the debt by a single levy now, and so to do away with the obligation to pay interest on it in the future, or to repay the debt gradually and face large interest charges for a long term of years? This issue it is the business of the present chapter to examine. But, before that task is entered upon, it is desirable to clear out of the way a popular argument which rests on misunderstanding.

Question

2. The problem to be faced, it is said, has an exact analogy in individual life. A man in debt to the extent of £6000 borrowed at 5 per cent has to choose between paying interest and reducing the principal of his debt slowly—orthodox finance—and paying off the whole debt at once—the policy of the special levy. It is impossible to decide which of these two courses would be more advantageous in any general or absolute sense. The right choice depends on the circumstances of the debtor. If, however, he has contracted the debt in resisting an attack by a powerful neighbour, and if, in the course of the contest, his resources have been strained to breaking-point, the issue is not doubtful. He *must* repay gradually, for the simple reason that he

cannot repay at once. The United Kingdom at the present time, the argument runs, is in exactly this position. The war has so impoverished us that the enormous payments, which a special levy would involve, are wholly out of the question. Staggering under the losses of the war, we have welcomed the offer of the United States to allow us to postpone for three years the payment of the *interest* on our American debt; to talk in these circumstances of wiping out great slices of principal is visionary nonsense. This reasoning sounds plausible. But it misses a vital distinction. Whereas the individual we have been imagining owes the whole of his debt to other people, the British nation owes practically the whole of its (net) debt to itself. So far as it is indebted to foreigners, its position is analogous to that of an individual debtor. But, so far as it is indebted to British citizens, its position is quite different. To repay debt of this kind involves no drain on the resources of the community as a whole, because, though one part of the community transfers resources to another part, the community as a whole pays nothing. It follows that, whereas the impoverishment of an individual may make it impossible for him to pay off the principal of a debt due from him, and the impoverishment of a community may have the same effect on it so far as its debt is held by foreigners, this impoverishment cannot make impossible the repayment by the community of a debt held by its own members. This becomes obvious when we reflect that the community can, if it chooses, impose on each of its

members a levy exactly equivalent to that member's holding of State debt. Thus, the analogy between internally held national debt and debt due from individuals is not a valid one.

3. The direct effect of the imposition of a special levy to wipe out debt is to lessen the amount of revenue that is required, and, therefore, the rates of taxation which have to be imposed, in future years. At first glance it might, perhaps, be thought that the percentage reduction in rates of taxation would necessarily be equal to the percentage reduction in revenue raised. This, however, is not so. Under the British Income-tax the interest received by the holders of the national debt is itself counted as income assessable to tax in the same way as all other income. If, therefore, national debt involving annually 300 millions of interest (we need not for the moment trouble about sinking fund) were paid off, the assessable income of the country in future years would be 300 millions less than it would have been otherwise. If, as is sometimes believed—though statistical data adequate to a satisfactory estimate are not available,—our assessable income now is between 4 and 5 thousand millions, 300 millions will represent about one-fifteenth of the whole. Therefore, after the debt had been wiped out, it would require rates of taxation fifteen-fourteenths as high as before to yield any given revenue; and a reduction in the aggregate amount of revenue needed by, say, one-third would involve a reduction in tax rates, not of one-third, but of two-sevenths. Of course, this is a very rough

approximation. In the absence of data concerning the distribution of war loan among different income classes subject to different rates of tax no exact statistical statement can be made. The general tendency is, however, plain. Other things being equal, the reduction in the rates of taxation, which the repayment of the national debt through a special levy would make possible, is slightly smaller than it might be thought to be at first sight. But there is also a consideration on the other side. It will be argued immediately that high rates of taxation tend to check production. If this is so, any given lowering of the rates must benefit production. This means that, in consequence of it, the amount of the country's real income will be increased, and, other things being equal, this increase is likely, as will be shown later, to be associated with an increase in money income also. It follows, therefore, that, if the amount of revenue to be raised by taxation is reduced by, say, one-third, the rates of taxation may be reduced by something more than one-third, and yet suffice to yield the reduced revenue now required. This consideration pulls the opposite way to that set out above. Which of them is the more important it is impossible to determine. It is, however, very unlikely that they will exactly balance, and, therefore, very unlikely that the percentage reduction in tax rates made possible by a cancellation of debt will be exactly equal to the percentage reduction in revenue required. But this is a secondary matter. For the present purpose it is enough to know that a substantial reduction in

revenue required will make possible also a substantial lowering of tax rates.

4. We have now to argue, as was forecast in Chapter VIII. 9, that, even though the income raised by taxation were all simply transferred within the country, being neither handed over to foreigners nor yet spent by government in the production of goods and services, nevertheless high rates of taxation would discourage work and saving, and so check national productivity. When a man knows that, out of every extra £1 that he succeeds in making, the government will take 5s. 5d., he will tend to stop working a little sooner than he would do otherwise. When he knows that, out of the yield of every extra £1 that he puts by, the government will take 6s., he will tend to stop saving a little sooner. The check to work means that production at the moment is carried less far than it might have been, and the check to saving hinders the expansion of capital equipment, upon which production in the future depends. Moreover, if the rates of taxation in this country are high, not only absolutely, but also relatively to those ruling in other countries—and they are bound to be higher than in countries that were neutral during the war, and may be higher than in former belligerent countries, should these themselves decide to wipe out debt by a special levy—the damage to production will be intensified by a tendency on the part of some rich people to take themselves and their capital abroad. When to income-tax are added various sorts of indirect taxation, there will follow, besides a reduction in

the quantity of production, a disturbance in its direction—a diversion of resources from the sorts of production that people would favour if left to themselves—and, therewith, a further element of real loss. These considerations lead to two very important propositions. The first is that, whatever the amount of the annual budget, to relieve that budget to the extent of 300 millions (or of any other sum) will have a good effect on national productivity. The second is that, the greater the annual budget, and, therefore, the higher the rates of taxation which it involves, the greater the benefit resulting from a diminution of 300 millions in revenue requirements is likely to be. The reason, of course, is that, while a certain amount of money can be raised by taxation of a kind and a degree that is not specially obstructive, as more and more money is required, resort must be had to worse and worse kinds of taxation and to more and more oppressive rates. From these propositions it appears to follow that the imposition of a special levy now to wipe out our immense war debt, since it would enable taxation to be substantially reduced from a level that is dangerously high, would promote work and saving and, through them, national productivity in a very important degree.

5. The amount of force in this argument for a special levy clearly depends on *how high* tax rates generally will have to be in order to finance the debt charges, together with other government expenditure, if a levy is not imposed. Some evidence as to this can, of course, be derived from the existing

facts. But, since we are concerned with tax rates, not merely at the moment, but over a long period of years, account must also be taken of future prospects. If there is reason to believe that, before very long, the high rates of taxation that rule now will no longer be necessary, the case for a levy is so far weakened ; on the other hand, if there is reason to believe that even higher rates will be required, the case is made stronger. It is, therefore, important to inquire what, in fact, future prospects are.

First, it is often urged that, as the world in general, and this country in particular, recover from the effects of the war, the rate of interest at which it is possible to borrow money will fall : that, therefore, the government may hope to effect a conversion of its long-time debt, replacing, perhaps, its 5 per cent obligations by obligations of $4\frac{1}{2}$ per cent or even 4 per cent. If it succeeds in doing this, the amount of revenue, which will be needed to provide interest on any given amount of war debt, will be proportionately reduced, and, consequently, less high rates of taxation will suffice. There is, of course, some force in this consideration. But it is less important than it appears to be at first sight. To begin with, while the greater part of our national debt bears interest at 5 per cent, war loan at this rate now stands in the market at under 90. This means that money on government security cannot now be borrowed at much less than 6 per cent. The rate of interest will, therefore, have to fall very decidedly below its present level before it will be possible for the State to reborrow on terms more favourable

than 5 per cent. The prospect of reborrowing on terms substantially more favourable than this is, therefore, somewhat remote. Moreover, even if the rate on which new borrowing could be effected were substantially below 5 per cent at the present time, a large part of our war loan cannot, under the terms of issue, be repaid at par until a number of years have elapsed. Finally, even if conversion made it possible some years hence to reduce the interest payable on the national debt by as much as one-tenth on the average, this could hardly lead, in view of the continuing need of other government expenditure, to a reduction in the aggregate revenue required of more than one twenty-fifth. The possible reduction in rates of taxation which this would make possible, though it would do something, could not possibly do much, to make the need for a special levy less urgent.

Secondly, there is good reason to believe that the productive power of this country will continue to increase in the future as it has done in the past. Possibly, as a result of the stimulus of war, it may even increase at an accelerated pace. This increased productivity will involve increased incomes, and so, it is argued, will make it possible to raise the same revenue as now by means of much lower rates of taxation. There is in this contention an important element of truth ; but some qualification is necessary. Plainly, if our national debt were contracted in terms of commodities, an increase in the productivity of the United Kingdom *must* make it easier to budget for the annual debt charges. Whereas,

before the improvement, these charges absorbed, say, one-twelfth part of the real income of the people, after it they might absorb, say, one twenty-fourth part ; and the rates of taxation associated with them might be roughly halved. But the national debt is contracted in terms, not of commodities, but of money. This complicates the issue. If increased production has no effect in reducing prices, money incomes will increase in the same proportion as production increases ; and the rates of taxation needed to yield a given revenue will be diminished to exactly the same extent as they would be under a system of payment in kind. In fact, however, an increase of production tends, other things being equal, to cause a fall in prices, and if, as is to be expected, the increase is not confined to this country, but is world-wide, a very considerable fall. But, when prices fall, a given volume of production is represented by a smaller money income. If, for example, production doubles, but at the same time prices fall by a quarter, the sum of real incomes will be doubled, but the sum of money incomes will only be increased to one and a half times the former amount. This does not prevent the increased productivity from having its full effect in lowering the rates of taxation needed to finance *normal government expenditure*, because a government that still wishes to buy the same quantity of things and services as before will now require only three-quarters as much money revenue. But the position is different as regards *government expenditure on debt charges*. The money revenue needed to meet these is the

same as it was before. Real incomes all round have been doubled, but money incomes have only increased in the proportion of 3 to 2. Consequently, the rates of taxation required to finance war debt will not be halved, but only reduced in this latter proportion. It should be added that an increase in productivity up to double its existing amount in any short period would be a very exceptional occurrence. It has been calculated that in recent times the average increase has been about 3 per cent per annum. Hence, while the case for a special levy to wipe out war debt is weakened in some degree by the prospect of increased productivity, it is not weakened very much, and is certainly not weakened to so great an extent as it might seem to be at first sight.

— There remains a third consideration. In Chapter XV. it was observed that, as a consequence of the war, the value of gold in terms of things has greatly fallen throughout the world; or, in other words, that gold prices have everywhere greatly risen. Moreover, owing to the 'specific' depreciation of sterling in terms of gold, sterling prices have risen substantially more than gold prices. It was argued that in future years gold prices are likely, through the operation of causes acting on the side of currency, to move, by slow degrees, nearer to the pre-war level than, on the average of slumps and booms, they tend to stand now. Whether or not this happens, it is practically certain that the British Government will endeavour to restore the pre-war parity between sterling and gold, so that £1 sterling

shall again be worth 4.86 gold dollars instead of, as at present, a little under 4 gold dollars. Hence, while the prices of things in terms of gold are likely to fall through currency causes, the price of gold in terms of sterling will almost certainly fall. This means that, apart from the oscillations of business cycles, the prices of things in terms of sterling will probably trend downwards to some extent, and may do so to a considerable extent. If, however, a fall of prices due to currency causes comes about, the money incomes, representing given real incomes of the people, must fall correspondingly. Hence, in order to raise a given money revenue to meet debt charges, the government will have to impose rates of taxation higher—perhaps much higher—than are required now. We must not, of course, ignore the effect of a fall in prices upon that part of government expenditure which is not concerned with the debt. This expenditure should be reduced proportionately with the fall in prices. Consequently, the aggregate money revenue needed by the government will not increase, relatively to the aggregate money income of the country, to the same extent as the part of the revenue that is required for debt finance. Still, the proportion between these two aggregates, and, therewith, rates of taxation, must increase to some, and may increase to a substantial extent. These considerations are important. The heart of the matter can be set out in a crude statement thus: if prices are halved through currency causes, the tax-payers will have to pay to fund-holders the equivalent of twice

as many things as they have to pay now : fund-holders will gain and taxes will increase to exactly the same extent as they would have done if prices had remained constant and all war obligations had been doubled in amount. The imposition now of a special levy to wipe out debt would protect us from this danger. This is a strong point in its favour.

6. We may now, leaving aside speculations as to interest rates, productivity and price levels in the future, come back to the central argument. Broadly put, the case for a special levy is that, by enabling the high rates of taxation, which would otherwise be necessary, to be reduced, it would encourage work and saving, and so indirectly stimulate national productivity. This central argument is open to several objections, which have now to be considered. The most far-reaching of them may be summarised as follows. "Granted," it is said, "that high annual taxation over a long term of years is injurious, is there any reason to suppose that a single levy to wipe out debt, which, though it only takes place once, must be enormously larger than the contribution of any single year under the taxation system, will be less injurious? Will not the greater size of the levy cancel the benefit of its less frequent imposition?" This objection, in the above general form, is not valid. A special levy to wipe out debt must be assessed on the basis of existing facts, on the capital that people have now, or on the income that they have now, or, at all events, on the basis of some objective criterion that is known now. Con-

sequently, whatever different individuals have to pay—it does not matter whether they have to pay at once or are allowed to pay in instalments—is fixed independently of their future conduct. Thus, a special levy of, say, 200 per cent of a man's current income is roughly equivalent in yield to a permanent income-tax of 10 per cent. But, whereas the permanent 10 per cent tax implies that one-tenth of whatever he may get in the future by work or saving will be taken by the government, under the 200 per cent single levy, he will have to pay a definite amount, fixed once and for all; and, however much he may increase his income in the future, he will not have to pay anything more. Unless, therefore, people are afraid of further levies, the single levy plan is bound to hurt production less than the continuing tax plan.

But the qualifying clause in the last sentence brings up a new and very important objection. The imposition of a large special levy for the purpose of paying off debt cannot fail, it is said, to create an expectation that it will be repeated, not merely to wipe off any debt that the first levy may have left standing, but also, it may be, for purposes not connected with debt redemption at all. This expectation will discourage people from saving and so adding to the capital stock of the country, and this check to capital will react injuriously on productivity. The injury wrought in this way will, it is urged, be very great. It cannot, moreover, be prevented by any assurance of the Cabinet, or even of Parliament, that a repetition of the levy

is not contemplated, because no government can effectively bind its successors.

There is force in this argument. But it is open to an effective rejoinder. So long as a 'capital levy' forms a plank in the programme of an important political party, the fear that a levy will be imposed exists already. It is even arguable that, when once a levy had actually been made, people would feel that things were settled, at all events for a considerable time, and would, therefore, be actually less fearful of the future than they are now. In any event, it must be remembered that, if the levy policy is rejected, there is the *certainty* of long-continued high taxes. Will not this be more damaging to enterprise than the speculative fear of a distant and uncertain danger?

There is, however, yet another line of attack. It is often argued that the process of paying a large levy could not be carried through without completely dislocating industry and commerce; and that, therefore, however speciously theorists may urge that the repayment of debt by means of such a levy would promote national productivity, in practice it must enormously diminish it. This contention is expressed in several forms. First, it is argued generally that any levy plan involves withdrawing an enormous sum of capital from industry, thus robbing it of its means of life. This, however, is not so. Industrial capital consists of factories, machines, materials and the store of goods out of which real wages come. None of these are withdrawn. The utmost that can happen is that so

much purchasing power is taken by the government from one set of people (the payers of the levy) and handed over to another set of people (holders of war loan) inside the same country. This can have no direct effect upon industry in general. Secondly, this being granted, it is argued that capital would, nevertheless, have to be withdrawn in large masses from particular industrial concerns, that this capital would probably not be immediately replaced, and that, therefore, many concerns might be forced to close down. This argument is more substantial than the other. It points to a real difficulty. But the difficulty is much smaller than the argument suggests. The reason is that the main part of the industry of the country is in the hands of public companies, and that these companies, not being subject to the levy (though, of course, their shareholders are subject to it), cannot suffer any withdrawal of capital. There remain private concerns. So far as the owners of these possess resources outside their business—war stock, for example, that is not serving as security for loans—sufficient to meet the levy upon them, they would be able to manage. It is true, however, that if firms, the whole of whose resources is locked up in their business either directly or as collateral for loans, had to meet a large levy all at once, they might be broken and their business largely destroyed. For such firms it would be necessary to make special provision. This can and should be done by permitting the Treasury, when good cause is shown, to accept payment (with interest) in instalments spread over a definite number

of years. There is no reason, and, indeed, it would be very undesirable, that this method of payment should become the normal one. But it might appropriately be used for the relief of hard cases. In like manner, for any imposts levied upon professional men and other owners of the immaterial capital of personal qualities, government would, no doubt, have to be content with a series of annual payments rather than with a large lump sum. In a later paragraph something further will be said on the subject of these imposts ; but they are bound, in any event, to be of small importance relatively to the imposts on owners of material property.

There remains the argument that, even though a special levy would not injure industry directly through real capital, it would injure it indirectly through finance. In order to raise the money to pay their quotas, people, it is said, would be compelled to throw securities on the market to such an extent as to cause a serious fall in values, and this would not only dislocate arrangements for loans on collateral, but would give rise to a financial panic, with inevitable repercussions upon industry. This argument rests on a misconception. Even though the levy had all to be paid in actual cash, since the proceeds would be employed in paying off holders of war loan, these people would presumably have about as much money seeking securities as the payers of the levy had securities seeking money. Any momentary gap between the time of the levy and the time of using it to buy war loan could easily be adjusted through the banks. There is, therefore,

no reason to fear anything like a general slump in values, though, of course, some particular securities might suffer a little relatively to others. But this is not the whole answer. There would be no need to require payment of the levy in cash. Payment in war loan stock would be even more acceptable to the Treasury, and payment in other first-class securities not less acceptable. Arrangements might also be made, as under the German Capital Levy Law, by means of a specially created institution for holding property on behalf of the State, to permit people who so desired to pay in other less readily marketable securities, or even in some forms of real property. It is very unlikely that, with reasonable arrangements on these lines, any considerable part of the levy would, in fact, be paid over in cash. The contention that the imposition of a special levy would damage productivity through its financial repercussions is, in short, devoid of substantial basis.

7. Were we, however, to stop at this point, we should not have a true picture of the situation. The whole of our discussion so far has turned on the assumption that a large special levy to wipe out debt is an alternative to, and a means of avoiding, high taxation. This assumption may be denied. If, it may be argued, a levy is imposed, and, in consequence, the annual revenue required to provide interest and sinking fund on the debt greatly reduced, the result will be, not lessened taxation, but increased extravagance on the part of the government. Having found that it is possible to maintain, for example, an income-tax at a standard rate of 6s. in the £,

the government will merely use the saving on debt interest as an excuse for more spending ; so that in the end, instead of the levy being a substitute for high annual taxes, it will turn out to have been an addition to them ! This argument is, from a practical standpoint, a very important one. There can be no doubt that, when so large an amount of revenue has to be raised that the tax system is strained, this fact strengthens the hands of the opponents of public wastefulness. The argument, "the country cannot afford unnecessary officials, and so forth," has a greater backing of votes when the budget is 1000 millions than when it is 200 millions. It is true that against this must be set the attitude of mind of the spending departments themselves. With a budget of 1000 millions, such a sum as, say, 10 millions seems a bagatelle, whereas, with a 200 million budget, it is a grave matter. This consideration is, however, almost certainly outweighed by that just set out. On the whole, a wiping out of war debt would weaken the country's defence against government extravagance.

This, however, is not the whole case. Not all sorts of government expenditure are waste. A government may easily be accused of extravagance because it has increased its expenditure on educational services, the payment of old age pensions, or other socially ameliorative enterprises. The cry, 'we cannot afford this,' may, in short, be directed against good things as well as against bad. It may even happen that it is more effective against the good things : that the Treasury, for example, has

greater success in vetoing a 10 million increase in educational charges than in clipping, to the extent of 10 millions, the wings of some unduly 'grandiose' ministerial establishment. This is a real danger. There are, of course, limits to the extent to which it is for the national advantage for the government to spend money on social betterment. But the limits are chiefly, though not entirely, dependent on the proportion between the real income of the country and the real expenditure which it undertakes through the agency of the government. So far as the budget is swollen by charges connected with internal debt, it does not represent this real expenditure, because the money raised to meet the charges is not spent in any ordinary sense, but is merely transferred from one group of citizens to another. This fact not being generally realised, the case against further government expenditure has an appearance of greater strength than properly belongs to it. No doubt, this helps resistance to wasteful spending; but it also, at least equally, promotes resistance to wise and desirable spending. This is a fair rejoinder. Should new government expenditure be undertaken in consequence of the relief to the budget brought about by debt repayment, it is gratuitous to assume that it will all be mere waste. Some of it, at least, is likely to be expenditure which ought to be undertaken, but has not been undertaken hitherto because of the technical difficulty of enlarging an already enormous budget, coupled with the inability of the public to understand the distinction between taxation for real expenditure

and taxation for interest on internal debt. It is true that good government expenditure, equally with bad, involves a forcing up of tax rates. But, since good expenditure is, almost by definition, expenditure the advantage of which is greater than the disadvantage involved in raising the money for it, such increase of rates as it involves cannot be taken to cancel the original lowering of the rates for which a levy is responsible. The whole of that lowering must be counted to the levy for righteousness, even though the country decides, after the lowering has been accomplished, to put rates up again in a cause that it considers worth the damage to production that high rates involve. We may conclude, therefore, that the case for keeping debt unrepaid, as a means of dragooning spendthrift governments, is not a strong one. The balance of argument so far is in favour of imposing a special levy to secure quick cancellation.

8. Up to this point, however, attention has been confined to the effect which the policy of a special levy for debt repayment would be likely to have on national productivity. Nothing has been said about distribution. Plainly, however, our provisional conclusion in favour of the levy policy might be reversed if it could be shown that that policy could not be carried through without great unfairness. It is sometimes maintained that in fact great unfairness is inherent in the policy. If, it is said, the present generation pay off the whole, or the bulk, of the war debt by a special levy, people now living will have shouldered the whole costs of the war.

But the benefit in security and so forth that the war may be supposed to have won for us will be enjoyed also by future generations. It is reasonable, therefore, that they should pay their share; and, if there is a special levy, they will not do this. In the light of the analysis set out in Chapters IV. and VIII. it is not necessary to delay long over this argument. It has been shown that the way in which the real burden of war costs is distributed between the future and the present is determined by the extent to which the individuals who actually finance war at the time it is being waged draw upon resources that are, or would normally have become, capital. What they have done in these matters cannot be altered by any post-war financial operations: and, though, no doubt, as an indirect consequence of these operations, the extent to which individuals now decide to create new capital may be indirectly increased, the benefit which this confers on the future cannot properly be said to be at the expense of the present. The question of fairness, as between different generations, may, in short, be set aside.

9. Plainly, however, the question of fairness between different people among the present generation cannot be dismissed in this way. It has been claimed that the policy of a special levy involves fundamental inequities in this matter, which suffice to condemn it in principle without reference to any particular form of it that may be proposed. Thus, it is said, a levy is bound to be unfair, because it hits indifferently people who have already suffered

heavily on account of the war and people who have made fortunes out of it. A man whom the war has already deprived of half his wealth is now, it is said, threatened with the further loss of half of the remainder, and the war profiteer is treated in no way differently. The general drift of this contention is, of course, correct. It is not, indeed, suggested that, if one of two men, who had equal fortunes before the war, has lost half his fortune while the other has doubled his, the two men would, under a levy, be mulcted equally by the State. They would not even be mulcted *in equal proportions*, because the levy would presumably be graduated so that richer men paid at a higher rate than poorer men. But it is suggested, and it is true, that, in the assessment of a special levy, no allowance is generally contemplated for the losses that some persons have incurred during the war and for the gains that other persons have made. If, however, this fact is used to condemn a special levy, it must equally be used to condemn the whole body of existing taxes; for no one of our taxes, whether direct or indirect, makes allowances of this kind. The truth is, and it has only to be stated to be perceived, that this argument, though *pro tanto* a valid argument in favour of the exceptional taxation of war fortunes, if that should prove to be practicable, is not a valid argument against a levy on all wealth designed to wipe out war debt. No doubt, if the issue to be decided was between this type of levy and a war wealth levy calculated to yield an equal sum, the argument would be highly relevant. But nobody has ever supposed that

a war wealth levy can yield enough money to make any decisive impression on the national debt. It is not, therefore, an alternative, though it may be a supplement, to the wider type of levy. The only alternative to that is continued high annual taxation of the ordinary type over a long period of time. This taxation fails, in exactly the same way as the levy would fail, to discriminate against war wealth. Plainly, therefore, the fact that the levy fails to do this cannot properly be used as an argument against it.

Again, it has been argued that a levy, in so far as it strikes accumulated capital, is bound to be unfair, because it mulcts people who have saved money during the war and lets off those who, with equal opportunities but less patriotism, have squandered their money in luxurious expenditure. That a levy must act in this way is, of course, true. But, here again, exactly the same thing holds good of the alternative system of continued high taxes. A man who had £10,000 a year during the war was taxed during the war on that £10,000. If he saved half of it, he will be taxed again in the future on all the income that the saved half yields; but, if he spent all of it, he will not be taxed again at all. This inequity cannot be remedied by any action open to the government now except resort to retroactive legislation. No attempt is made to remedy it in any existing tax. The fact, therefore, that it would not be remedied in a special levy, which is an alternative to some existing tax, cannot properly be used as an anti-levy argument.

Yet again, it has been urged that the imposition

of a levy, so far as it strikes accumulated capital, would be in substance, though not, of course, in form, a breach of faith with all the people whom the government persuaded during the war to purchase war loan. Now, of course, if it was proposed to make a levy on holdings of war loan from which other forms of private wealth were exempt, this charge would be justified. But no such proposal has ever been made. War loan would be treated in exactly the same way as—certainly it would be treated no worse than—other forms of property. It has always been understood that income from ordinary war loan will be treated, for taxation purposes, like other income. There is no inequity, therefore, in treating ordinary war loan capital like other capital. On this general issue there is no room for serious dispute. There are, however, two subordinate considerations to which attention should be called. First, it is sometimes argued that, though in theory a levy would not discriminate at all against the holders of war loan, yet in fact it would do this, because, since everybody's holdings of war loan are recorded at the Bank of England, any levy made in respect of them would be certainly recoverable, whereas some holders of other forms of property would probably, by concealment, evade a part of their lawful obligations. This is, no doubt, true; but evidently, though it affords a strong argument for making the collection of any levy that may be imposed as effective as possible, it cannot serve as sufficient ground for refusing to impose a levy. If such a contention were conceded, it would be impossible

to impose any tax at all ; for always some people are in a stronger position than others to evade their lawful obligations. Secondly, there is a small amount—some 20 millions—of 4 per cent war loan that was issued free of income-tax ; and war savings certificates are also free of income-tax. In so far as a levy is regarded as an alternative to income-tax, the holders of these securities have a valid claim for exceptional treatment under any levy that might be imposed. What exact form this exceptional treatment should take need not be considered here. The amount of money affected, in comparison with the general scale of our problem, is trifling. It is enough to note that some special adjustment in this matter is necessary. Taken in the broad, the arguments about unfairness that have been reviewed above are, in my judgement, quite inadequate to overthrow the favourable view of a levy policy, to which we have been led by a consideration of its probable effects upon national productivity.

10. Let us now suppose that the policy of a special levy is accepted in principle. It then becomes necessary to face the difficult task of framing a satisfactory basis of assessment. Here the most fundamental issue turns on the treatment to be accorded, on the one hand, to owners of material capital and of income derived from material capital, and, on the other hand, to owners of the immaterial capital of personal capacity and of income derived from that. A "levy on capital" is usually thought of by the public as being concentrated exclusively on owners of accumulated

wealth, and as leaving aside altogether owners of immaterial capital. Such a partial levy is plainly unjust. One man, we may imagine, has spent £10,000 in buying some property that is expected to yield him an income of £1000 over the next fifteen years; another has invested the same sum in training and developing his own mental powers in such a way as to enable him to earn £1000 a year for the next fifteen years. Under a capital levy as ordinarily understood the first of these men would be hit and the second allowed to go free. There can be no warrant for this. Moreover, if the levy is conceived, as I have suggested it may be, as a substitute for future taxation, it is plainly proper that those who have the power to earn income, since they will benefit from the reduction of future taxation, should bear a share of the levy. Unless they are made to do this, the imposition of the levy will have the effect of substantially altering the burden borne by different citizens, to the advantage of those possessing the immaterial capital of capacity to do profitable work and to the disadvantage of those possessing material capital as ordinarily understood. This shifting of burden is exactly similar to that which would occur if the policy of a levy were rejected in favour of the orthodox system of annual taxation, but the rates of tax on unearned, or investment, income (*i.e.* income from property) were largely raised, and those on earned income largely reduced. Of course, it is open to any one to maintain that the existing discrimination between the rates of income-tax on

the two sorts of income is less favourable than it ought to be to earned income. But nobody would propose exempting earned income altogether ; and this is what, in substance, would be done, in respect of whatever tax revenue was affected, by relieving future taxation through the agency of a levy imposed upon material capital alone. Equity, therefore, requires that the special levy should not be imposed upon material capital alone, but that the power to make earnings should also somehow be brought under it.

II. Granted that owners of accumulated wealth and owners of immaterial capital are both to be brought under contribution, it has still to be decided whether assessment should be made upon them on the basis of capital in a wide sense (including immaterial capital) or on the basis of income, or on a mixed basis. This problem will be considered from three points of view : that of national productivity ; that of equity ; and that of administrative technique.

On the side of productivity all that need be done is to clear out of the way a common fallacy. It is often argued that imposts on capital are necessarily more injurious than imposts on income, because they trench, in a way that imposts on income do not, on the productive equipment of the country. This is a blunder. It arises out of a failure to distinguish between the *object* on which an impost is assessed and the *source* out of which it is paid. An impost assessed on capital may quite well be paid out of income, and one assessed on income out of capital—or,

what comes to the same thing, out of resources, which, apart from the tax, would have been turned into capital. The choice of the object of assessment does not, in short, determine the source of payment. Nor, in general, does it have any significant effect upon the source of payment. Suppose, for example, that the government decides to take £100 from a man with £10,000 of capital yielding £500 of income. It can do this either by a 20 per cent income-tax or by a 1 per cent capital tax. There is obviously no ground for supposing that the man will take the £100 he has got to pay from one source if the tax is called an income-tax, and from another if it is called a capital tax. The widespread confusion of thought that exists on this matter arises in a very simple way. As a matter of practice, imposts assessed on capital, such as death duties, call for much larger payments at one time than imposts assessed on income. The larger, however, an impost becomes, the greater is the proportion in which it is likely to be taken out of capital. If, for example, a man has to pay in a year more than his income for the year, he *must* draw on capital. It is easy to imagine death duties on about the present scale assessed on a basis, not of capital values, but of the income in the last completed year before death. Nobody would contend that a change of this kind would alter the extent to which death duties are paid out of capital. It is the same with a special levy. *Given the amount of the levy,* it would make very little difference to the source out of which it comes, and, therefore, to national pro-

ductivity, whether the basis chosen for assessment were capital or income.

I turn to the question of equity. For ordinary annual taxation it is generally agreed that annual income is a fairer basis of assessment than capital. Of course, if every £100 of income implied exactly the same amount of capital (material or immaterial) as the source of the income, the choice between income and capital as a basis of assessment would have no significance. When £100 of income is derived from £2000 of capital, it makes no difference, interest being reckoned at 5 per cent, whether income is taxed 20 per cent or capital 1 per cent. In either event exactly £20 a year is raised. But, in fact, the relation between income and the capital from which it is drawn is not the same for all incomes. Thus, one property is expected to yield £100 a year for ever; another is expected to yield nothing at all for ten years, and, thereafter, to yield about £163 per annum for ever. If the rate of interest is and remains 5 per cent, the first of these properties is worth now, and will continue to be worth, exactly £2000. The second is also worth now (approximately) £2000, but its value will gradually increase, until after ten years it will become £3260, thereafter remaining at that figure. Under a 20 per cent income-tax the former of these properties pays £20 a year from now onwards: the latter pays nothing for ten years and, thereafter, £32:12:0 a year. These two sets of payments have equal present values, and, since the two properties are equal, this is clearly right. If, however,

capital is taken as the basis of taxation, the former property, as before, pays £20 a year from now onwards; but the latter, besides paying £32 : 12 : 0 a year annually after ten years have passed, also pays during the first ten years an annual sum starting at £20 and gradually rising to £32 : 12 : 0. In the aggregate, therefore, it pays more tax than the other, although its present value is equal to that of the other. What happens in effect is that the income after ten years is taxed both when it arrives and also in anticipation of its arrival. We thus see that the adoption of a capital basis for annual taxation causes properties which are expected to appreciate to be taxed too much relatively to stable properties; and, by parity of reasoning, it causes properties which are expected to depreciate to be taxed too little. It is true that against this disadvantage of the capital basis there has to be set an advantage. One property—a holding of war loan, for example—may be worth £10,000 because it yields £500 a year of money income; another property—a yacht, for example—may be worth an equal sum because it yields an equivalent income, not in the form of money, but directly in satisfaction. The taxable capacity of a man who owns his own £10,000 yacht is substantially the same as that of one who, having £500 more of money income, spends this in hiring a yacht from somebody else. Under the income basis of annual taxation, since income-tax takes account only of money income, the yacht owner goes free, but the yacht hirer is hit. Under the capital basis this inequity disappears, and

both men are taxed equally. This advantage of the capital basis must, as I have said, be set against the disadvantage described above. On balance, however, there can be little doubt that the disadvantage is the more wide-reaching of the two. Moreover, if the capital basis were adopted, it is difficult to see how the disadvantage associated with it could be palliated; while that associated with the income basis can be, and has been, in some measure met by the imposition of special duties—such as the motor-car tax—on possessions that yield an income of amenity.

It is sometimes thought that the reasoning which has led to the general adoption of an income basis for ordinary annual taxes can be extended, without further debate, to the assessment of a special levy. Indeed, certain critics of current proposals for a levy on capital have believed that these proposals can be overthrown by the citation of familiar arguments against annual property taxes. This is a mistake. The fact that income is a better basis than capital for continuing annual taxation is no evidence that it is a better basis for a special levy to be raised on a single occasion. In fact, it can easily be shown to be a worse one. The objection to a capital basis for continuing taxes is that on this basis properties yielding little or no return now, but destined to yield a substantial return presently, are taxed on their future return both now and also in the future. When we have to do, not with continuing taxes, but with a single levy, this objection changes sides. If the income basis is adopted,

people with capitals that are of great value because they are expected to yield income some years hence will pay nothing at all. Plainly, they ought to pay. For annual taxation the income of the year, supplemented, perhaps, by special amenity duties on certain durable consumption goods, is the fair basis, because the income of every year is subjected to tax. For a single levy ability to pay depends, not on the income of the particular year in which the levy is made, but on the prospects of income over a considerable period. Capital measures this, but the income of the current year frequently does not. Moreover, the owners of such things as yachts and pearls and motor-cars, who may or may not be hit for annual purposes by supplementary amenity duties, are fairly sure to escape under a special levy unless this is based on capital. For these reasons it seems clear that, from the point of view of equity, capital is a better basis than income for the assessment of a special levy.

There remains administrative technique. Under this head one thing is clear. The assessment upon owners of the immaterial capital of personal capacity *cannot* practically be made in the form of an assessment of capital. Such a task the revenue authorities could not reasonably be invited to undertake. The capital value of a man's capacity to earn so much income depends on the man's expectation of life, and so would be different for men in similar occupations but of different ages. Account would have to be taken too of prospects of promotion; and, in strictness, not merely of existing capacity, but

also of capacity to acquire capacity. Clearly this will not do ; we are in the region of fiscal dreams. The assessment of owners of immaterial capital must be made by way of income. There are several ways in which this could be done. The simplest is that material capital alone should be assessed for the special levy, but that the resultant injustice to property owners, as against rich professional men, should be countered by a readjustment in the relative rates at which earned incomes and investment incomes are assessed to income-tax. Since the special levy on material capital would represent the conversion of so much tax on investment income, investment income would be entitled to a relief from future income-tax to which earned income has no claim. There are, of course, other alternative ways in which the required adjustment could be made. In accord with the general argument set out on pp. 202-3, we ought, if possible, to choose one that makes future imposts depend on incomes and prospects as they exist now, rather than on future incomes ; for then work will not be discouraged. For the present purpose, however, it is not necessary to consider this matter further. It is sufficient to recognise that the evaluation of immaterial capital for the purpose of a special levy is impracticable, and that the owners of such capital must be brought under contribution somehow through their incomes.

As regards owners of material capital considerations of administrative technique are less decisive. Clearly there is *some* advantage in making income, rather than capital, the object of assessment. In

the United Kingdom an enormous mass of knowledge about people's incomes is already in the possession of the revenue authorities. The machinery of income-tax administration could readily be turned on to assess a special levy, at whatever rates were desired, on the basis either of current incomes or of the average of incomes over, say, the last three years. If, on the other hand, a special levy had to be assessed on a capital basis, the problem of a general valuation would have to be faced. For some sorts of property this would not be a very serious matter. For wealth the titles to which are held in the form of securities a simple return could be asked for, and it could be checked to some extent by means of the knowledge already in the hands of the inspectors of taxes. For securities for which there is a wide market values could then be satisfactorily determined by reference to the prices that had ruled in the market over some assigned period. For securities that are not often dealt in it would be more difficult to make a fair valuation. Property not represented by securities would present much greater difficulties. Here, either immediately or, at all events, as an ultimate check on the returns, there would have to be a special appraisalment by government valuers. Private businesses, houses, furniture, jewellery, works of art and other such things would all, so far as it was decided to include them under the levy, have to be treated in this way. It would be impossible to carry through such a general appraisalment quickly, and it could hardly fail to prove both irritating and expensive. These

difficulties, however, are not insuperable. At least three alternative ways of dealing with them are available. First, all persons *prima facie* liable to levy might be required to send in a valuation of their properties by some assigned date. On this valuation they might be assessed in the first instance. Thereafter, government appraisers might set to work and gradually, during the course of several years, might go through these private valuations and, where necessary, correct them. After the proper valuation had been finally determined, any adjustment required on account of the corrections might be effected by payments from the tax-payer to the Exchequer or *vice versa*. Secondly, the levy might be assessed in the first instance on the basis of those kinds of property only, the valuation of which presents no difficulty. Such things as furniture, jewellery and works of art might be left over till each several property comes up for valuation in the natural course at the owner's death. Then the ordinary death duty assessment might be supplemented by a further assessment in respect of postponed special levy upon these things. The disadvantage of this method is, of course, that it makes difficult the proper graduation of the levy. The rate of levy should vary with the aggregate size of different properties. If only a part of these properties is brought under review when the main levy is assessed, this cannot be done. Any error that results might, however, be corrected by manipulating the rates at which the supplementary levy is assessed later on. Thirdly, elements of property

which are exceptionally intractable to valuation might be left out of assessment altogether, on the ground that, though this would, undoubtedly, be unfair, yet a certain amount of unfairness must, as in all tax matters, be endured in order to avoid administrative complications. Clearly, no one of these devices is wholly satisfactory, and this fact is, so far, an argument against making capital the basis of assessment. It is well to remember, however, that, in view of the large amount of property that is held in the form of securities, probably not more than one-quarter would involve any serious difficulty in valuation. Moreover, even though a very large proportion of the objects specially awkward to value—furniture, jewellery, works of art and other forms of consumption capital—were left outside the range of capital assessment, the capital basis might still be much better than the income basis; for on the income basis all these things are ignored completely.

On the whole, balancing equity against convenience, I am inclined to sum up in favour of the capital basis, subject to the condition that the precise range of capital which it is worth while to include is studied and determined by revenue experts. It is desirable to add, however, in so many words, because the point is not always understood, that the decision for or against the broad policy of a special levy is not dependent on any conclusion that we may come to about the basis of assessment. A special levy on property-owners *could*, if it were so desired, be assessed on the basis of their income. It does not stand or fall with any particular plan,

or, indeed, with the whole body of possible plans, for making a valuation of capital.

12. Whether a capital or an income basis is decided upon, it would be necessary, in any practical scheme for a special levy, to define carefully the range of persons to be covered. It would seem *prima facie* that the net should be spread wide enough to cover all owners of property situated in England, except the owners of temporary bank balances, and all regular residents in England wherever their property is situated. As with income tax, however, there are bound, in this region, to be many difficulties of detail, for which no perfectly satisfactory solution can be found. Moreover, there are other delicate points that have to be settled. The most important of these concerns the relation between natural persons (*i.e.* individuals) and fictitious persons (*i.e.* companies and corporations). In the United Kingdom income tax is assessed on the income accruing to individuals through companies in which they have shares, and also on that part of the income of companies which is not distributed to shareholders but passed to reserve. This analogy suggests *prima facie* that under a special levy both the shares of companies in the hands of shareholders and also the reserves of the companies should be assessed. But this is incorrect. The capital value of the shares represents the whole value of a company's property, including the reserves in whatever form they may be held. When, therefore, share capital has been assessed in the hands of the shareholders, all that

there is has been assessed once. To come down on the companies again would involve double taxation. Companies, therefore, should be left outside the levy. The position of corporations whose property is not represented by shares, such as universities, colleges, churches, clubs and so forth, is, however, different. If they are not made subject to the levy in their own persons, their property will escape altogether. In principle clearly it ought not to escape, though it is arguable that certain sorts of corporations of special public utility should be exempted for the same reason that the income of charitable trusts is exempted from income tax. If they are not exempted a further difficulty has to be faced. A scale of levy graduated appropriately to individuals could not be applied to corporations. It would be absurd, for example, to make an institution like a college, comprising a large number of persons, and possessing, say, a million pounds, contribute as large a quota as an individual millionaire. It would be necessary, therefore, to fix, for such corporations as it was decided to assess, some general arbitrary flat rate substantially below the maximum rate under the scale. This plan should probably be extended to cover municipalities and other local authorities. The logic of the situation requires that trade unions, friendly societies and co-operative societies should also be assessed, though it might be proper, in view of the comparative poverty of most of their members, to apply a different and lower flat rate to these bodies.

13. A more fundamental problem is to determine

the rates of levy proper to people of different degrees of wealth. Everybody would agree that under a special levy, as under an ordinary income-tax, people below a certain level of wealth should be exempted altogether, while, for people above that level, the rates of levy should be made to increase with increases of wealth, in such a way that, if one man's wealth exceeds another's in any given proportion, his levy payment should exceed the other's in a larger proportion. It is impossible, however, to lay down any general principle in accordance with which either the level of the exemption limit or the form of the graduation scale should be determined. As with income-tax, so also here we are forced to rely on the subjective judgment of governing persons as to what, on the whole, seems to them to be reasonable.

14. This problem of distribution as between people of different degrees of wealth is exactly analogous to that which arises in connection with income-tax and involves no niceties. The problem, however, to which we now turn, of distribution as between single persons, married persons without children, and married persons with large families has, in connection with a special levy, puzzles peculiar to itself. It is generally agreed that, for income-tax purposes, a man with a wife and family should be taxed less than a man of equal income who has only a wife, and that such a man in turn should be taxed less than a bachelor. Would it be proper to make the same class of allowances under a special levy? At first sight, the answer to this

question seems clearly to be yes. But there is a difficulty. A man may be a bachelor one year, a married man the next year, a married man with five children six years hence, and, it may be, a widower with no children at all seven years hence. Under income-tax all these vicissitudes are followed from year to year, and appropriate adjustments are made for them. But a special levy is not an annual tax ; it is a single impost raised once only. If allowances corresponding to income-tax allowances are made in it, the man who has a wife and large family alive in the year in which the levy happens to be made is favoured as against the man who is a bachelor then, but is going to have a large family in a few years' time. The advantage which the first of these two men obtains is plainly arbitrary, and cannot be justified on grounds of fairness. For this reason the case for family allowances is very much weaker under a special levy than it is under income-tax. No entirely satisfactory solution of the difficulty seems to be possible. It is true that arrangements can be imagined that would take account of a man's probable future family status as well as of his actual status—under which, for example, a bachelor of twenty would be treated differently from a bachelor of sixty ; but they would almost certainly prove too complicated and too controversial for practice. Probably the most generally acceptable solution would be to make some allowances, at all events among poor people, but to keep them small.

15. What has been said leads up to yet another

problem. In the United Kingdom there is a system of graduated duties on properties passing at death, which, for large properties, are at a very high rate. If a man died immediately after his property had been mulcted under the special levy, the remainder of that property would at once be hit again. On this ground it may be argued that the special levy should be assessed at a lower rate on old men than on young men with equal incomes. But the inference is not well-grounded. After all, a young man may die immediately after the levy as well as an old one. A more appropriate way of meeting the difficulty would be to make some allowance in respect of death duties for estates falling under them soon after they had paid the special levy. No allowance for age in the special levy itself seems to be called for.

16. The results of the foregoing discussion may now be summarised in a few sentences. In view of our enormous budget requirements and of the consequent necessity for kinds of taxation and rates of taxes that are seriously repressive to industry, a large special levy for the purpose of repaying internal national debt is desirable from the standpoint of national productivity. On the whole, capital seems to be a better basis for the assessment of a special levy than income, though an assessment based on income would be easier to administer. If, as in practice would certainly happen, the immaterial wealth of mental and manual earning powers proved intractable to assessment on this basis, it would be fair either to review the comparative rates of income-tax upon earned and unearned incomes in the light of this

fact or to make some other compensating adjustment.

✓ A levy, if made, should be graduated, and persons below a certain limit of wealth should be exempt. The revenue authorities would need to investigate what, if any, categories of wealth it would be desirable, in the interests of administrative simplicity, to leave outside the scope of the levy. ✓ Payment of ✓ levy quotas should be accepted, not merely in cash, but also in war loan stock and, probably, other first-class securities. Provision should be made to allow of payment by instalments from persons to whom immediate payment would involve exceptional hardship. The imposition of a special levy conceived on these general lines, the proceeds to be devoted to repayment of debt, would, if the decision to adopt it were accepted loyally and did not meet with organised obstruction, help forward the economic recovery of the United Kingdom. Detailed proposals and estimates of the amount of money that would be yielded by different scales of levy can only be made satisfactorily by the Inland Revenue authorities. Such inadequate study as I have been able personally to make suggests that a reasonably graduated scale rising to a maximum of between 40 per cent and 50 per cent might bring in between 3000 and 4000 million £.

CHAPTER XVIII

THE AFTERMATH OF GOVERNMENT CONTROL

1. WITH the ending of the war there inevitably arose a keen discussion as to how far the widespread control over industry, that governments everywhere had gradually come to exercise, should be retained. Everywhere in actual fact controls were relaxed. But this relaxation was bitterly opposed. It was argued that, under the impulse of uncontrolled private profit-seeking as it normally operates, resources are used up in pandering to the whims of the rich, while essential needs of the mass of the community are still unsatisfied. Thus, at a time when there is a crying shortage of houses, and when the transport of essential articles is held up for want of railway wagons, some 200 millions a year are being spent on pleasure motoring. In London alone there are 363 motor-car shops, many of them with "large show-rooms and a little army of immaculately dressed showmen and others employed in and about them."¹ Against this wasteful result of freedom is set the experience of the war

¹ Chiozza Money, *The Triumph of Nationalisation*, p. 29.

period, when the government compelled engineering firms to give up the manufacture of luxury goods and concentrate upon the essential needs of the State. In war public action built national factories where energy was centred on social needs: in peace these factories are sold to profit-seeking private enterprise and at once diverted in large part to making luxuries. Had the public rule of industry been continued into peace, it would have directed our national resources into the channels of reconstruction—the building of houses, the re-equipment of the railways and the overhauling of mines. Private enterprise freed from control failed to do these things; it squandered the nation's energy for trivial and futile ends.

2. This reasoning sounds very persuasive. But there is a deep-rooted confusion. The essential fact of war-time was that the government got into its own hands, by a combination of taxes, loans and credit creation, the predominant part of the purchasing power of the country. It wielded this purchasing power to direct productive forces towards the common end of victory. It speeded up the transition from peace organisation to war organisation. By shutting off certain sorts of production it impelled people, instead of building themselves houses and so on, to hand their incomes over in war loan. But—and this is the point—unless the State had been prepared to take and use—had, indeed, deliberately sought—a great volume of purchasing power for itself, much of the control exercised over industry would have been futile.

The purpose of the main part of it was either to enable the State's holding of purchasing power to be employed as effectively as possible, or indirectly, by shutting off rival uses, to induce people to add to its purchasing power. Had the State chosen in peace to continue the policy of absorbing purchasing power and using it for common ends, then, with or without control on the side of production, houses could have been built for the poor instead of motor cars for the rich. But, unless it had chosen to do this, mere retention by it of control on the side of production would not have enabled these things to be done. If purchasing power is so distributed that the effective demand is for pleasure touring cars, industry, however organised, must make these things; if it is for jerry-built and cheap houses, because people cannot afford to buy good houses, industry, however organised, must produce them. It may, indeed, be urged that the government ought to control the distribution of purchasing power, and so to prevent it from being used in these ways in peace just as it did in war. For the first year or two of 'reconstruction' there is much to be said for that policy. But, as a permanent policy, it is impossible. It is impossible, because to go on, year after year, raising purchasing power by loans and credit creations can only lead in the end to national bankruptcy and general collapse. As a permanent policy, the State can only absorb for common purposes such an amount of purchasing power as it is prepared to raise by taxation. This is bound to be a much smaller sum

than it was raising in war time by a mixture of taxation, loans and credit creation: for to press taxation beyond a point is apt grievously to check the industry, enterprise and saving of the people, and so to destroy the source from which it comes. With the very large State requirements to meet national debt charges and other unavoidable Treasury outgoings, the government naturally hesitates before plans the adoption of which would force the rate of taxation to what may well be thought a dangerous height. So soon, however, as its dominance over distribution is surrendered, its control over the direction of industry—over the purposes to which the nation's real resources are devoted—must necessarily lapse also.

3. There is, however, another sense of government control which must not be confused with the above. That is control, not over the direction of industry generally, but over the internal policy of particular industries. When the British Government took over the railways it brought about a decidedly larger measure of co-operative working than had been customary before. Thus, the trucks belonging to private colliery companies that were used upon the railways were pooled, traffic was deliberately regulated with a view to general economy instead of to the profit of competing companies, and so on. In like manner, attempts were made to organise coal distribution on a general plan, so that the several markets were supplied from mines near to them and cross-freights saved. Yet again, among the various engineering firms turned on to munition-making,

government action led to a sharing of information about methods and processes, in place of the wasteful secrecy of normal competitive production. Undoubtedly this and other new forms of co-operation were responsible for considerable economy in production ; and the resumption of pre-war conditions might be expected to mean substantial loss. On the other hand, if separate concerns, having learnt from the war the way to these economies, continue to co-operate, there may easily grow out of them powerful quasi-monopolistic organisations, able, if they choose, to mulct the public heavily. Here is a serious dilemma. Nobody wishes to lose the economies which co-ordinated effort has shown to be possible : but everybody is afraid that co-ordinated effort under private enterprise may lead to monopolistic arrangements dangerous to the public. The way out can be found only in an extension of government control over the internal policy of certain industries—more especially railways and coal mines—that formerly were left, in the main, to their own devices. Whether control should be carried to the point of some form of ‘ nationalisation,’ under which a publicly appointed body would actually take over and operate these industries, or should stop short at supervision and regulation from outside, is a subject of hot debate. But that *some* control for the protection of consumers will need, henceforth, to be exercised over a fairly wide field is now generally agreed.

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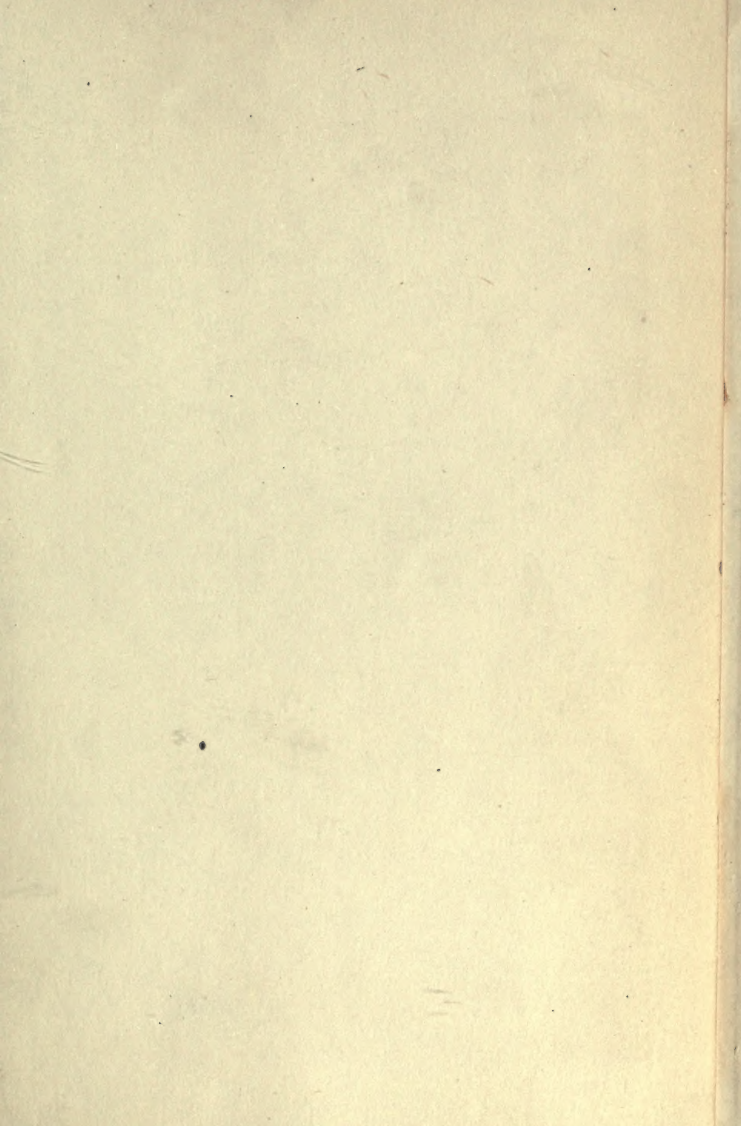
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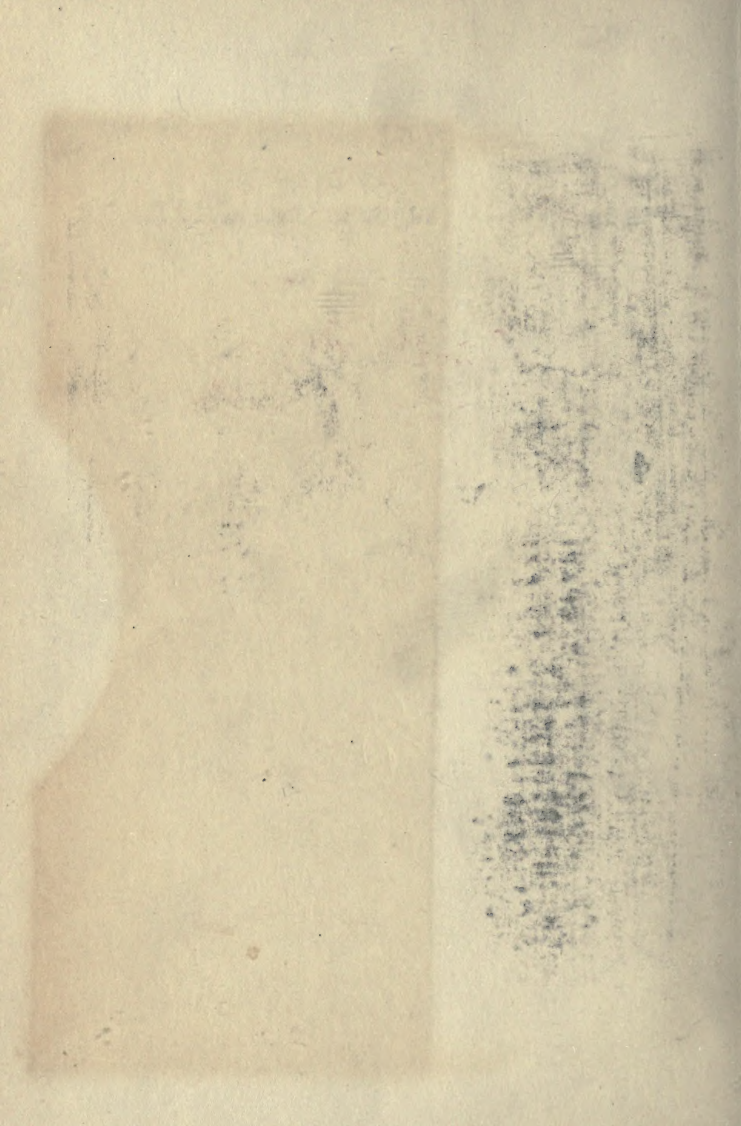
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